

FINANCING THE SOCIAL SECURITY SYSTEM

PROGRAM EXPERIMENTATION
BRANCH LIBRARY

HEARINGS
BEFORE THE
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE
COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES
NINETY-FOURTH CONGRESS

FIRST SESSION
ON
FINANCING THE SOCIAL SECURITY SYSTEM

MAY 7, 14, 15, 20, 21; JUNE 17, 18, AND 19, 1975

Printed for the use of the Committee on Ways and Means

ORD INFORMATION
RESOURCE CENTER, HCFA



Information
Resource
Center

PROGRAM EXPERIMENTATION
BRANCH LIBRARY

LAW 13.7

FINANCING THE SOCIAL SECURITY SYSTEM

KF
3643
.45
1975h

HEARINGS

BEFORE THE

SUBCOMMITTEE ON SOCIAL SECURITY

OF THE

COMMITTEE ON WAYS AND MEANS

HOUSE OF REPRESENTATIVES

NINETY-FOURTH CONGRESS

FIRST SESSION

ON

FINANCING THE SOCIAL SECURITY SYSTEM

MAY 7, 14, 15, 20, 21; JUNE 17, 18, AND 19, 1975

Printed for the use of the Committee on Ways and Means



U.S. GOVERNMENT PRINTING OFFICE

COMMITTEE ON WAYS AND MEANS

AL ULLMAN, Oregon, *Chairman*

WILBUR D. MILLS, Arkansas	HERMAN T. SCHNEEBELI, Pennsylvania
JAMES A. BURKE, Massachusetts	BARBER B. CONABLE, Jr., New York
PAN ROSTENKOWSKI, Illinois	JOHN J. DUNCAN, Tennessee
PHIL M. LANDRUM, Georgia	DONALD D. CLANCY, Ohio
CHARLES A. VANIK, Ohio	BILL ARCHER, Texas
RICHARD H. FULTON, Tennessee	GUY VANDER JAGT, Michigan
OMAR BURLESON, Texas	WILLIAM A. STEIGER, Wisconsin
JAMES C. CORMAN, California	PHILIP M. CRANE, Illinois
WILLIAM J. GREEN, Pennsylvania	BILL FRENZEL, Minnesota
SAM M. GIBBONS, Florida	JAMES G. MARTIN, North Carolina
JOE D. WAGGONNER, Jr., Louisiana	L. A. (SKIP) BAFALIS, Florida
JOSEPH E. KARTH, Minnesota	WILLIAM M. KETCHUM, California
OTIS G. PIKE, New York	
RICHARD F. VANDER VEEN, Michigan	
J. J. PICKLE, Texas	
HENRY HELSTOSKI, New Jersey	
CHARLES B. RANGEL, New York	
WILLIAM R. COTTER, Connecticut	
FORTNEY H. (PETE) STARK, California	
JAMES R. JONES, Oklahoma	
ANDY JACOBS, Jr., Indiana	
ABNER J. MIKVA, Illinois	
MARTHA KEYS, Kansas	
JOSEPH L. FISHER, Virginia	

JOHN M. MARTIN, Jr., *Chief Counsel*
J. P. BAKER, *Assistant Chief Counsel*
JOHN K. MEAGHER, *Minority Counsel*

SUBCOMMITTEE ON SOCIAL SECURITY

JAMES A. BURKE, Massachusetts, *Chairman*

JOE D. WAGGONNER, Jr., Louisiana	BILL ARCHER, Texas
WILLIAM J. GREEN, Pennsylvania	BARBER B. CONABLE, Jr., New York
ANDY JACOBS, Jr., Indiana	WILLIAM A. STEIGER, Wisconsin
J. J. PICKLE, Texas	PHILIP M. CRANE, Illinois
WILLIAM R. COTTER, Connecticut	
JAMES R. JONES, Oklahoma	
ABNER J. MIKVA, Illinois	
JOSEPH E. KARTH, Minnesota	

CONTENTS

Press release of Friday, April 25, 1975, announcing hearings on financing the social security system.....	Page 2
Press release of Wednesday, May 28, 1975, announcing second stage of hearings on financing the social security system.....	505

DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE WITNESSES

James B. Cardwell, Commissioner, Social Security Administration, James E. Marquis, Assistant Commissioner for Program Evaluation and Planning, A. Haeworth Robertson, Chief Actuary, Lawrence Alpern, Deputy Chief Actuary, Francisco Bayo, Deputy Chief Actuary, and Mary Jane Fiske, Deputy Assistant Secretary for Legislation-Welfare (HEW).....	3
Hon. Caspar Weinberger, Secretary, James B. Cardwell, Commissioner of Social Security Administration, Hon. Stephen Kurzman, Assistant Secretary for Legislation, and A. Haeworth Robertson, Chief Actuary, Social Security Administration.....	435
James B. Cardwell, Commissioner, James E. Marquis, Assistant Commissioner for Program Evaluation and Planning, Samuel E. Crouch, Acting Director, Bureau of Disability Insurance, Robert L. Trachtenberg, Director, Bureau of Hearings and Appeals, and Mary Jane Fiske, Deputy Assistant Secretary for Legislation-Welfare (HEW).....	474

PUBLIC WITNESSES

American Association of Retired Persons, National Retired Teachers Association, Isaac Fine, Pete Hughes, and James M. Hacking.....	520
American Life Insurance Association, Robert J. Myers and William B. Harman, Jr.....	569
American Public Welfare Association, Wilbur J. Cohen.....	621
Ball, Robert M., Washington, D.C.....	596
Ballard, Brenda, National Association of Manufacturers.....	640
Brittain, John A., Brookings Institution.....	359
Brown, William R., Council of State Chambers of Commerce.....	507
Calvert, Geoffrey N., Pomenson/Alexander Ltd.....	359
Cohen, Wilbur J., University of Michigan, Wayne State University, and American Public Welfare Association.....	621
Council of State Chambers of Commerce, James B. Hallett and William R. Brown.....	507
Cruikshank, Nelson, National Council of Senior Citizens.....	653
Danstedt, Rudolph T.: Social Security Advisory Council.....	102
National Council of Senior Citizens.....	653
Feldstein, Martin, Harvard University.....	359
Fine, Isaac, American Association of Retired Persons, National Retired Teachers Association.....	520
Hacking, James M., American Association of Retired Persons, National Retired Teachers Association.....	520
Hale, Randolph, National Association of Manufacturers.....	640
Hallett, James B., Council of State Chambers of Commerce.....	507
Harman, William B., Jr., American Life Insurance Association.....	569
Hobbs, Charles B., Washington, D.C.....	589

IV

Hughes, Pete, American Association of Retired Persons, National Retired Teachers Association.....	Page 520
Klint, Walter E., National Association of Manufacturers.....	640
Moser, Charles A., Washington, D.C.....	557
Myers, Robert J.: Temple University (in his own behalf).....	359
American Life Insurance Association.....	569
National Association of Manufacturers.....	640
National Association of Manufacturers, Walter E. Klint, Robert Myers, Randolph Hale, and Brenda Ballard.....	640
National Council of Senior Citizens, Nelson Cruikshank and Rudolph Danstedt.....	653
Pomenson/Alexander Ltd., Geoffrey N. Calvert.....	359
Public Citizen Tax Reform Research Group, Patricia S. Senger.....	542
Senger, Patricia S., Public Citizen Tax Reform Research Group.....	542
Smith, J. Henry, Social Security Advisory Council.....	102
Social Security Advisory Council, W. Allen Wallis, J. W. Van Gorkom, Rudolph Danstedt, and J. Henry Smith.....	102
Taeuber, Conrad, Georgetown University.....	359
United Auto Workers, Howard Young.....	359
Van Gorkom, J. W., Social Security Advisory Council.....	102
Wallis, W. Allen, Social Security Advisory Council.....	102
Warschauer, Thomas, College of Business Administration, University of Maine.....	549
Young, Howard, United Auto Workers.....	359

MATERIAL SUBMITTED FOR THE RECORD

American Federation of Labor-Congress of Industrial Organizations, Andrew J. Biemiller, statement.....	669
Biemiller, Andrew J., American Federation of Labor-Congress of Industrial Organizations, statement.....	669
Chamber of Commerce of the United States, Andrew A. Melgard, statement.....	675
Melgard, Andrew A., Chamber of Commerce of the United States, statement.....	675
New York Community Service Society, statement.....	684
Renshaw, Edward F., Albany, N.Y., statement.....	686
Rohrer, Daniel M., Chestnut Hill, Mass., statement.....	687
Schnepper, Jeff A., New Brunswick, N.J., statement.....	688

FINANCING THE SOCIAL SECURITY SYSTEM

WEDNESDAY, MAY 7, 1975

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The subcommittee met at 3:30 p.m., pursuant to notice, in room H-208, the Capitol, Hon. James A. Burke (chairman of the subcommittee) presiding.

Mr. BURKE. The subcommittee will come to order.

The first public hearing of the Subcommittee on Social Security is about to begin.

The principal subject matter of these hearings will be the financing of the social security cash benefits program. This is a very timely and important subject matter, since substantial problems have developed with respect to the financial condition of the program, both for the short-range and long-range.

These problems, I hasten to add, are substantial, but by no means insoluble. I am entirely confident that this subcommittee, which has some of the ablest Members of the Congress, will be successful in formulating legislation that will assure the continued operation of the social security program throughout the lifetimes of our children's children.

We will be studying difficult and complex questions in the months ahead. Many questions have already been posed by the American people. Many of these questions have also received the attention of experts in various fields, including economists, actuaries and those connected with public and private retirement systems. We hope, during these hearings, to gain the benefit of the best thinking that has been devoted to these matters.

The agenda of the initial phase of the subcommittee's hearings is set forth in a press release issued on April 25, 1975, which I will have inserted in the record following my remarks.

During the next few weeks, our hearings will be limited to taking testimony from administration witnesses and invited panelists. Following this, the subcommittee will conduct general public hearings as soon as they can be scheduled among the total activities of the full committee.

The purpose of today's hearing is to receive a presentation of the 35th annual report of the Board of Trustees on the old age and survivors and disability insurance trust funds. The presentation will be made by James B. Cardwell, Commissioner of Social Security, and his assistants. The Commissioner is also the Secretary of the Board of Trustees.

Now, I might say, in way of explanation, that there is a markup session going on by the full Committee on Ways and Means, on the energy bill, and it is impossible to have all of the members of the Social Security Subcommittee here today. So, we will just have the presentation of the trustee's report by the Commissioner today, and then we will recess until May 14, at which time, we will continue the hearings and go into the matter in great depth.

[The press release follows:]

[Subcommittee on Social Security press release, Apr. 25, 1975]

CHAIRMAN JAMES A. BURKE (D., MASS.), SUBCOMMITTEE ON SOCIAL SECURITY, COMMITTEE ON WAYS AND MEANS, ANNOUNCES PUBLIC HEARINGS ON THE FINANCING OF THE SOCIAL SECURITY SYSTEM

Chairman James A. Burke (D., Mass.), Subcommittee on Social Security of the Committee on Ways and Means, today announced the scheduling of a limited series of hearings focusing principally on the financing of the social security system. These hearings will be limited to receiving testimony from Administration witnesses and from selected panelists. Testimony from the general public concerning the financing of the social security system will be received at subsequent hearings before the Subcommittee. A tentative schedule for these preliminary hearings is as follows:

May 7, 1975, 3:30 p.m., H-208, Capitol.—Representatives of the Board of Trustees of the Social Security Trust Funds, to discuss the 1975 Annual Reports of the federal Old Age and Survivors' Insurance and Disability Insurance trust funds.

May 14, 1975, 1 p.m., Main Hearing Room.—A panel of representatives of the Social Security Advisory Council will testify, beginning at 1 p.m., in the Main Hearing Room of the Committee on Ways and Means. (In the event the full committee is meeting at that time—or on any of the subsequent days of the subcommittee's hearings—the hearings will be held from 8 a.m. to 10 a.m. in the Main Hearing Room and concluded in that same room in late afternoon.)

The following members of the Social Security Advisory Council will participate as panelists:

W. Allen Wallis, Chairman; Chancellor of the University of Rochester; former special assistant to President Eisenhower;

J. W. Van Gorkom, President, Trans Union Corporation, Lake Forest, Illinois;
John W. Byrnes, Attorney; former Member of House Ways and Means Committee;

Rudolph Danstedt, Assistant to the President of National Council of Senior Citizens;

J. Henry Smith, former Chairman of the Board, Equitable Life Assurance Society of the United States.

May 15, 1975, 1 p.m., Main Hearing Room.—A panel of actuaries and economists. The following will participate as panelists:

Robert Myers, Professor Actuarial Science at Temple University; former Chief Actuary, Social Security Administration;

Geoffrey Calvert, Actuary and Employee Benefit Consultant, Pomenson/Alexander Ltd., Vancouver, British Columbia;

Howard Young, Actuary, United Auto Workers, Washington, D.C.;

John Brittain, Economist, Brookings Institution;

Martin Feldstein, Economist, Harvard University;

Conrad Taeuber, Georgetown University, Director of Center for Population Research.

May 20, 1975, 1 p.m., Main Hearing Room.—Administration witnesses, concerning the financing of the social security system.

May 21, 1975, 1 p.m., Main Hearing Room.—Administration witnesses, concerning problems of administering the social security program.

As indicated above, the Subcommittee plans to conduct general public hearings concerning the financing of the social security system following the conclusion of these preliminary hearings. An announcement concerning these later hearings will be made at a later date.

Mr. BURKE. You are recognized, Commissioner.

STATEMENT OF JAMES B. CARDWELL, COMMISSIONER, SOCIAL SECURITY ADMINISTRATION; ACCOMPANIED BY JAMES E. MARQUIS, ASSISTANT COMMISSIONER FOR PROGRAM EVALUATION AND PLANNING; A. HAEWORTH ROBERTSON, CHIEF ACTUARY; LAWRENCE ALPERN, DEPUTY CHIEF ACTUARY; FRANCISCO BAYO, DEPUTY CHIEF ACTUARY; AND MARY JANE FISKE, DEPUTY ASSISTANT SECRETARY FOR LEGISLATION (WELFARE), DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

Mr. CARDWELL. Mr. Chairman, thank you very much.

I would like to start out by introducing those of the social security staff who are with me here today

Mr. James Marquis is the Assistant Commissioner for Program Evaluation and Planning. To his left is Mr. Francisco Bayo, Deputy Chief Actuary; his expertise is long-range actuarial estimating. To his right is Mr. Haeworth Robertson, the new Chief Actuary of the Social Security Administration. I can't tell you how pleased we are to have him, after a long, long search, literally, around the world, for an actuary.

Seated next to Mr. Robertson is Mr. Lawrence Alpern, the Deputy Chief Actuary; his expertise is short-term estimates. And immediately behind him is Miss Mary Jane Fiske, representing the Secretary of HEW. She is a Deputy Assistant Secretary for Legislation.

I appreciate this opportunity to present to you the 1975 reports of the Boards of Trustees of the Social Security Trust Funds.

As the chairman pointed out, the Commissioner of Social Security is ex officio secretary of the Boards, and while I regret that members of the Boards are unable to be here today, I will do my best, on behalf of the trustees, to present highlights of the Boards' reports and to try to answer your questions.

I would note, at the outset, the fact that this is my first appearance before the newly formed Subcommittee on Social Security. Both as Commissioner of Social Security and as secretary of the Boards of Trustees, I would take this opportunity, Mr. Chairman, to express the willingness of the Department of Health, Education, and Welfare, the Social Security Administration and the Boards to cooperate with this subcommittee and its work in every way possible.

It is our hope that, through your subcommittee, we can continue the strong working relationship that has been developed over the years between the executive branch and the full committee.

I would like to begin the discussion by briefly reviewing the major features of the trustees' reports, after which I would propose to go into a detailed review of the future financial status of the system, particularly the cash benefits program.

To facilitate the presentation of the details, I have some charts which I will turn to at the end of my statement, with your permission, of course. Since a discussion of the trustees' reports necessarily involves a recitation of figures, I cannot avoid presenting an array of them in my statement, but I would remind you that you will have an opportunity to see the key figures again when we go through the charts.

Several changes in the law affected the operations of the cash benefits trust funds during 1974, and if the committee wishes, I would

be glad to skip over the 1974 background. But if you are interested, I would portray it in some detail. And I will seek your pleasure at this point.

Mr. BURKE. You may proceed as you wish, Commissioner.

Mr. CARDWELL. Well, I think, if it is okay with you, I would go to the future financial status, because I think that is where the major issues lie. And when we get into questions and answers, we can go back into 1974, if the committee wishes.

Mr. PICKEL. Mr. Chairman, I would like for him, if he would, just to summarize here—

Mr. CARDWELL. All right.

Mr. PICKEL [continuing]. 1974 activity, so that we might have general thoughts in mind.

You don't have to read it.

Mr. CARDWELL. All right.

First of all, there was a very significant general benefit increase of 11 percent. That was enacted in 1973, but it became effective in two steps in the report year 1974.

The retirement test exempt amount also increased, from \$2,100 to \$2,400. I would point out that today it stands at \$2,520 under the automatic escalators.

The OASDI contribution rate was increased from 4.85 percent for employees and employers, each, to 4.95 percent, each, on January 1, 1974, and the contribution and benefit base was increased from \$10,800 to \$13,200, also, effective in January 1974.

Income to the social security OASDI program during fiscal year 1974 amounted to \$57.7 billion, an increase of \$8.1 billion. Total outgo was \$55.9 billion, an increase of \$6.8 billion over the prior year.

At the end of fiscal year 1974, the assets of the OASDI trust funds amounted to \$46.1 billion—and we are going to refer to this figure quite often in our discussion this afternoon. This compares to \$44.3 billion which existed at the end of fiscal year 1973. The number of contributors to the OASDI program grew from 96 million to 101 million, and the number of beneficiaries increased from 29.1 million persons at the end of fiscal year 1973 to 30.2 million persons at the end of fiscal year 1974.

Income to the hospital insurance program, part A of medicare, in fiscal year 1974 totaled \$11.6 billion. This compares with \$8.4 billion in the prior years. Outgo for part A grew from \$6.8 billion in fiscal year 1973 to \$8.1 billion in fiscal year 1974. The assets of the hospital insurance trust fund grew by \$3.5 billion, to \$7.9 billion.

Income to the supplementary medical insurance program, part B of medicare, amounted to \$3.8 billion in fiscal year 1974, an increase of \$2.9 billion over 1973. Supplementary medical insurance outgo was \$3.3 billion, an increase of \$0.7 billion over fiscal year 1973. The assets of the supplementary medical insurance trust fund at the end of fiscal year 1974 amounted to \$1.3 billion compared with assets of \$700 million at the end of the prior year.

Since the 1974 trustees' report was issued, over a year ago, there have been several changes in the social security cash benefits program under the automatic adjustment provisions of the law. The first determination of an automatic increase in the contribution and benefit base—to \$14,100—was announced in 1974, effective at the start of this calendar year, January 1, 1975.

The retirement test exempt amount was increased automatically, as I mentioned earlier, to \$2,520, and that is where it stands today. This, also, of course, became effective on January 1.

Although it is a 1975 event, I would point out that the first automatic cost-of-living benefit increase has been determined, under present law, to be 8 percent. The President's budget in January forecast that figure as being 8.7 percent, but the first quarter of this calendar year produced smaller increases in the cost of living and the figure officially stands at 8 percent.

As you know, the President has proposed a 5-percent limit on this automatic increase, and Secretary Weinberger has recently restated the administration's interest in seeing this limit enacted. However, the trustees in their review of the status of the program under present law did not, of course, assume any ad hoc congressional action with regard to this year's benefit increase. They followed the law, literally. Their forecasts for 1975 through 1976 are based on the current law.

Under projections of both the short- and long-range financial status of the OASDI program, as shown in the trustees' report, expected expenditures will exceed income annually beginning this calendar year. I want to emphasize that. Outgo will exceed income beginning this calendar year, this tax year.

As you all are aware, a number of sensational and alarmist articles have appeared in the press and other places, suggesting that social security has gone broke. In my view, there is just no justification for such articles, and I think the report of the trustees points this out.

As I will point out today, the system is reacting predictably to the sudden changes that have occurred in the economy, and the funds' reserves provide proper safeguards to insure benefit funding for at least the next several years, even if we were to face trust fund deficits for a series of consecutive years. This is not to belittle the seriousness of the problems but to say that the system's reserves provide adequate time to deal with the situation in a thoughtful and deliberate way.

It is my opinion and my view that the fund is doing what we have organized and designed it to do and is serving us well at this point in time.

What are the short-term financing issues? With the fact that we have the reserves on hand in mind, let me amplify the short-term financial status of the OASDI program.

Under present law, expenditures under the social security old-age, survivors, and disability insurance program will exceed income by about \$3 billion this tax year. Current estimates in the trustees' report show that under present law annual excesses of outgo over income would continue into the future, reaching about \$7 billion by 1979. Clearly, we will need to act if we are to prevent depletion of the trust funds in the early 1980's, and we, in the administration, are developing specific proposals in this regard.

The current projections are, of course——

Mr. ARCHER. Mr. Chairman, would it be possible to interject some short questions as the Commissioner goes along here, so we could get a comment?

Mr. BURKE. Well, if we want to. Whatever the Commissioner would like to do.

Mr. CARDWELL. We are here at the pleasure of the chairman and the committee.

Mr. ARCHER. I would just like to ask, is that \$7 billion annual or cumulative?

Mr. CARDWELL. The annual level by 1979 would be \$7 billion.

Mr. ARCHER. That is all.

Mr. CARDWELL. What happens, as we are going to point out and as you will see when we get into in the charts, is that the annual deficit gets a little larger each year into 1979. At that time, it would \$7 billion.

The current projections are, of course, sharply different from the short-term projections given in last year's trustees' report. This, obviously, would be a period in which it has been particularly difficult to forecast accurately changes in CPI, levels of employment, productivity, and average earnings. And, as you know, the projections of trust fund operations are highly sensitive to forecasts in all these areas.

Since social security benefits are, by law, tied to the Consumer Price Index, higher than anticipated levels of inflation in the short-term future mean higher than anticipated expenditures for social security benefits. At the same time, today's increased levels of unemployment mean less income to the program, fewer workers paying fewer taxes.

The 1975 trustees' report assumes, in addition to the previously mentioned 1975 cost-of-living increase of 8 percent, future cost-of-living increases of 6.6 percent in 1976, 6.4 percent in 1977, 6.3 percent in 1978, and 4.8 percent in 1979, a curve of continuing inflation, but at lower levels than are being experienced today.

The assumption underlying the estimates in the trustees' report vary from those used in the preparation of the President's 1976 budget—page 41 of the President's budget. We understand that the latter assumptions are being updated and will be provided to the Congress as a part of the midterm report on the budget. That will be provided by the OMB and the White House.

The trustees' report assumes that the average unemployment rate will be 8.8 percent in 1975, 8 percent in 1976, 7 percent in 1977, 6.2 percent in 1978, 5.4 percent in 1979, and 4.8 percent in 1980.

Moving now to the long-term financial status as reported by the Board—a brief review of the changes over the past 2 years in the long-term status of the program will serve as both an introduction to the discussion of the long-range financial status of the program and as an illustration of the sensitivity of such long-term estimates to changes in economic and other assumptions.

As you will recall, the 1973 trustees' report showed the cash benefits program to have a long-range deficit of only 0.32 percent of taxable payroll. By November 1973, when the Ways and Means Committee was considering the bill which ultimately resulted in the two-stage 11-percent benefit increase that was enacted the following month, the deficit was estimated to be 0.76 percent. This increase in the deficit was due largely to higher than previously anticipated short-term rates of increases in the CPI.

The financing changes contained in the benefit increase bill—H.R. 11333—that was enacted in December 1973—Public Law 93-233—reduced the long-range deficit to an estimated 0.51 percent of taxable payroll. This reduction in the deficit was achieved, at that time, and

through that law, by increasing the earnings base for 1974 from the \$12,600 scheduled earlier to \$13,200 and by reallocating part of the HI tax rate to the OASDI program.

When the 1974 trustees' report was issued a year ago, in May of 1974, the actuarial deficit was estimated to have moved to 2.98 percent of taxable payroll over the 75-year valuation period. The major portion of this increase in the deficit was due to revised fertility projections based on 1970 census data which became available in 1973. The work force in the future was estimated to be considerably smaller in proportion to the number of beneficiaries than in earlier estimates.

Today's ratio of about 30 beneficiaries for every 100 workers covered by the program today is projected to increase to nearly 50 beneficiaries per 100 workers by the year 2030. Thus, proportionately fewer workers will be supporting a larger number of beneficiaries, and the cost of the program, expressed as a percentage of taxable payroll, will be substantially increased.

I would point out that long-term demographic trends of this sort will not begin to be felt for many years to come. Their major impact will not occur until about 2010.

Revised assumptions as to future movements of wages and prices also played a significant role in the 1974 forecast of a significant deficit.

Now, we come to the 1975 trustees' report. This report estimates the long-range deficit at 5.32 percent of taxable payroll, or 2.34 percent higher than the 1974 estimate, just a year ago. The largest single increment of increase involves new, long-range economic assumptions; in fact, the increase in the deficit of 1.95 percent of payroll that is attributable to economic factors accounts for about 83 percent of the increase.

A further factor in the increase in the projected deficit since the last trustees' report is the increased rate at which disability insurance benefits are being awarded and the length of time disability insurance beneficiaries remain on the rolls, eligible for payments.

Mr. ARCHER. Mr. Cardwell, is long-range deficit a 75-year deficit, is that what you are talking about?

Mr. CARDWELL. Yes, sir.

As you know, the cost of the disability program has been increasing in the last few years, and the estimates contained in the 1975 trustees' report have been updated to reflect actual experience through calendar year 1974, as well as to reflect the assumption that the award rate will continue to increase at 3 percent per year for at least the next 5 years.

The central set of long-range economic assumptions used in the trustees' report is based on an annual increase of 6 percent in average earnings and 4 percent in the Consumer Price Index for the period 1981-2049. To illustrate the sensitivity of program cost projections, the trustees have also presented estimates based on alternative long-range assumptions, and such estimates are contained in the report.

In citing these long-range projections, I would emphasize that the effects that they predict will, in the main, not be felt for many years. It is important to note, I believe, that there is ample time for deliberate consideration of alternative methods of restoring the long-range financial soundness of the program.

One element affecting the long-range financial status of the cash benefits program that deserves particular attention is the combined effect of price and wage increases on future benefits. The benefit adjustment mechanism under present law is extremely sensitive to the movement of prices and wages.

Under reasonable projections of rising wages and prices over the long range, benefits in the future could replace a much larger proportion of preretirement earnings than is now the case. Consequently, the costs of the program will increase substantially over the long term—the 75-year period we were speaking about.

The trustees recommend in their report—as did the 1975 Advisory Council on Social Security—that the system be modified so as to maintain a planned, constant and predictable relationship between benefit levels and the preretirement earnings on which the benefits are based. Modification of the benefit structure in this way holds a great deal of promise for helping to deal with the long-range financial deficit in the program. It could make a significant difference.

As I believe you know, the President has endorsed the general concept of a restructuring of social security benefits so as to provide stable and predictable replacement of preretirement earnings; in this sense, he adopted the recommendation of the Advisory Council in principle.

He has directed the Department of Health, Education, and Welfare and the Domestic Council to study alternative models for accomplishing this objective, with a view to developing a specific legislative recommendation to, of course, be presented to the Congress.

We also note, and I think this is important, that the Ways and Means Committee has joined with the Senate Finance Committee in asking the Library of Congress for a study of alternative proposals along this line, and I would emphasize that we, in the Social Security Administration, are in full cooperation with the effort. Because a benefit stabilization proposal could very significantly affect the long-range financing of the social security program, it seems prudent to hold in abeyance the question of dealing with the long-range financial deficit pending development and adoption of a specific benefit structure proposal. That should provide the basis for the long-term financing plan.

With regard to the long-range soundness of the hospital insurance program, the hospital insurance trustee's report notes that, while substantial excesses of income over outgo are projected for hospital insurance for the short-term, there is a very slight—0.16 percent of taxable payroll—long-range deficit in that program, as well; compared to the deficit in the cash benefits program though, it is quite modest.

Since the short-range imbalance is already upon us, it would seem that it should receive more immediate attention. For this reason, the Administration is focusing first on the question of how best to restore the short-range soundness of the program. Secretary Weinberger hopes to speak to this subject when he appears before the subcommittee later this month.

Whatever direction and method of short-term financing is finally chosen by the administration and the Congress, I believe it is useful to bear in mind some important questions of timing. While legislative action this year could go a long way toward alleviating public fears

and restoring public confidence, the state of the economy should be considered before any final decisions are made.

The reserves—and I would again repeat this—are sufficient to assure adequate time for deliberation and adequate time for individuals and organizations to make known their views and for the executive branch and the Congress to act. The point to be made is that revenue development for social security must, as the trustees point out, be consonant with plans for economic recovery.

Mr. Chairman, that concludes my prepared statement, and I would be happy to stop and try to answer questions at this point. But I would suggest that we review the charts first; I think they will open some better doors to questions.

Mr. BURKE. Commissioner, we have a rollcall right now, would you mind waiting for about 5 minutes?

Mr. CARDWELL. I would be pleased to do so.

Mr. BURKE. The subcommittee will stand adjourned for 5 minutes. [A recess was taken.]

Mr. BURKE. Commissioner, the Administration seems to have adopted the same view that the subcommittee has, to examine the short-range problems first and then look into the long-range problems.

What you are saying, apparently, is that the Administration is going to come in with its recommendations at a later date. Possibly Secretary of Health, Education, and Welfare, Caspar Weinberger, will appear with some recommendations at our hearings later this month.

I want to assure you that this committee is going to cooperate with the Administration in every way possible to find the best solutions to the problems of financing the social security program.

I don't believe there is any Member of the U.S. Congress who doesn't want to keep the social security trust fund as stable as possible. I think we do have to act on the short-range problem within a few months. There are many statements being made. We can't allow all these statements going out to the press. We have got so many people studying this problem, so many experts in the field, who all seem to have the answer. They are alarming millions of our social security recipients and also alarming those people who are working paying taxes into the trust funds.

We have to give the American people the assurance, which I know they are going to get. I don't see anything wrong with the short-range operation of the social security system that a few adjustments can't straighten out.

All the years I have been on the committee we made adjustment every few years and nobody could predict 3 years ago the changes that have occurred in the economy. What bothers me on the long-range prediction is that they couldn't predict what was going to take place in 3 years.

I think that with respect to the long-range predictions we will have to give those careful study. Some people have a crystal ball that they are looking into that nobody else has available to them.

Mr. Archer.

Mr. ARCHER. Well, Mr. Chairman, just to comment briefly on the end of your statement, I think a big part of the problem you mention was caused by the Congress.

The actuaries told us, when the Congress adopted the "dynamic earnings" concept, that their accuracy was not going to be nearly as good as it was on the "standard level earnings" concept. And I think it is up to us to give them something that they can have a chance to work with more accurately over the years to come.

We are going to see dramatic fluctuations, and it is going to be awfully difficult for them to, with any degree of accuracy, predict for 75 years in advance. Even the assumptions that I see for the near-term that are part of your report, Mr. Cardwell, I think are idyllic.

If you think the cost of living increase is only going to be 6.4 percent in 1977, after we attempt to digest a national deficit of over \$120 billion or \$150 billion in the period between now and then, I just don't see any way that you are going to have inflation down at 6.4 percent. And that means that even these short-term figures are going to be inaccurate.

Economists I talk to are looking at inflation figures considerably in excess of 6.4 percent in 1977 and 1978. So, even within the short-term, this dynamic earnings concept, in what the majority in Congress did to the social security program, is part of the problem, and it is not all your fault. But I would encourage you to be more forceful when you do come before our committee and express your concerns, because in 1973, when I attempted to pursue this before the Ways and Means Committee, I did not get the kind of realistic answers from the actuaries that I should have received at that time and the assertions that we need to assure that our job is done in the way that it should be done, prudently, because this is very, very important to the lives of all Americans.

I would like to ask you just quickly a couple of questions. At the present time, what does this 5-plus percent of payroll deficit mean in dollars over the long-term?

MR. CARDWELL. I would have to add it up. We are obviously talking about trillions of dollars.

MR. ARCHER. That 5 percent of payroll, that is 5 percent for the full 75 years?

MR. CARDWELL. An average of 5.32 percent, on the average payroll over 75 years.

Would the actuaries care to speak to that?

MR. BAYO. It is not possible to get a figure over 75 years, because of the change in the value of the dollar, according to the assumption itself.

One measure of—

MR. ARCHER. Measured in constant dollars, 1975 dollars, what would it be?

MR. BAYO. It depends on how you discount the dollar, either with the consumer price index or for wages. I think the best way to measure would be 5 percent on today's payroll. Payroll being about \$630 billion, 5 percent would be about \$30 billion per year.

MR. ARCHER. Thirty billion dollars per year, based on today's payroll. So, over a 75-year period, you could multiply by 75 and come up with a rough figure of two and one-quarter trillion dollars that the fund would be in deficit. There would be a deficit if we don't make the changes, and we are going to have to make some changes, as you happily pointed out.

At the present point, if we were to do nothing—and I think the Congress will not just do nothing—but assuming no action were taken, when do we reach the point under current estimates with a shortage of being able to pay the benefits under existing law?

Mr. CARDWELL. 1980 and 1981.

Mr. ARCHER. It is still 1980 and 1981, in spite of the reduced inflation since the last time we heard from you?

Mr. CARDWELL. Right. We are going to illustrate the decline in the funds on a year-by-year basis, when we get to the charts.

Mr. ARCHER. Would it not be preferable for us to contemplate the possibility of going back to a more accurate standard level earnings concept from your standpoint, rather than this dynamic earnings concept?

Mr. CARDWELL. Well, in terms of capacity, to estimate with improved accuracy, the answer would be yes. On a public policy choice, though, I think, the answer would be no. I think the concept of an indexed benefit represents a consensus of public choice and necessitates the use of dynamic assumptions.

There is a problem though, about the way the present system is designed and its effect—the indexing system's effect on long term future benefits for current workers. That is the problem that we point out in the statement. We think that needs correction.

But on the benefits' side, my personal opinion—I think, it represents the administration's general view—is that we should continue an indexed system.

The President proposed that we, for 1 year, put a constraint on that index, an artificial, one-time constraint, in order to try to break the cycle of rapid growth. But I think he was careful to point out that he was not advocating a permanent departure from the concept of an indexed system.

Mr. ARCHER. Well, it just seems to me that we cannot continue to live with a social security system that is subjected to crisis after crisis because of changes in the economic barometers, which cannot, no matter how expert you are, be predicted with certainty.

Mr. CARDWELL. Mr. Archer, I think that is——

Mr. ARCHER. And that is evidenced by the dramatic changes in your estimates that have occurred in just the last couple of years.

Mr. CARDWELL. I think it is the definition of a crisis. I think that the way we should deal with sudden changes in the economy, such as those that have occurred over the last couple of years, is through the use of the contingency reserve, and we should be very careful to be certain that that is as adequate as we know how to make it.

I think the system is quite well-designed to deal with sudden changes in the short term and is proving itself right now. It is not as well designed regarding the capacity to make accurate long term forecasts. You could even question the necessity of doing that. It isn't prescribed in law.

The value of the 75-year forecast is to demonstrate to the current workers and current public policy makers roughly what they were choosing for the long term. But I think, the main thing to emphasize is a system that has a contingency reserve that is clearly adequate for short term and sudden change.

I think the system is quite adequately designed in that regard, and I think it is proving itself. I wouldn't want to say the same thing about the long term.

Mr. ARCHER. Well, I, again, want to encourage you and your staff, when you appear before our committee, to speak out candidly, because, in 1973, we did something that, in my opinion, was completely irresponsible and which I voted against and pointed out. And much of what I said is coming true today; because we went off of a standard level earnings concept on which we had a deviation of point 1 percent, in your capability of accuracy, to a dynamic earnings deviation or variation of point 5 percent, as we were told, which has turned out to be worse than that.

Mr. CARDWELL. Yes.

Mr. ARCHER. And I don't blame you for that, but you at least told us that your degree of accuracy would go from 0.1 percent to 0.5 percent. The Congress then said that we can now settle for a deficit of 0.5 percent, which, to me, is total irresponsibility. But I didn't hear any strong comments from you at the time that I was making this point to the Ways and Means Committee and at which time we deliberated for only a few minutes on something that was going to affect the lives of all the people in this country and then quickly reported the bill out on a voice vote. I then also expressed my objections on the Floor of the House.

But at the time that I was attempting to elicit information from your people, I did not receive strong support, and I think you have a responsibility to candidly level with this Congress and to let us know what we are getting into.

Mr. CARDWELL. Mr. Archer, I would say to you, and I will say to the committee, that you are absolutely right. My responsibility as a Commissioner of Social Security and as an individual is to tell you what I think. And I assure you that is exactly what I will do.

Mr. ARCHER. Well, do you think it is responsible for the Congress, when the degree of accuracy of your estimates declines, to go to a bigger deficit in the fund? Do you think that is a responsible action?

Mr. CARDWELL. I am not advocating a deficit in the fund. Looking back at the history of the fall 1973 debate of this issue, the actuary said that it is not possible to develop a 75-year estimate with absolute accuracy and that the estimate could be off by as much as one-half of 1 percent of taxable payroll.

If they gave you an estimate that said zero, they would be misleading you. And I think that that is what they told you.

Mr. ARCHER. Well, the degree of accuracy has now obviously run up to plus or minus 5.32 percent.

Mr. CARDWELL. Yes, sir, because we have introduced as assumptions new projections; not projections that we ourselves created, but projections that other authorities created as to the future shape and size of the population.

Those data and the consensus that now exist around them didn't exist in the fall of 1973, and they show a marked difference. I think, if you will look at the history of demographic estimates, you will find that the record isn't very good for anybody.

Estimating how many children we will produce in this society is extremely difficult, and it is a factor in a lot of these long-range forecasts. The forecast depends on that kind of estimating technique.

And we should all understand that this is highly imperfect—I would underscore that.

Mr. ARCHER. But if we err, should we not err on the plus side, rather than on the deficit side?

Mr. CARDWELL. That would be my recommendation.

Mr. ARCHER. But based on the concept of the majority in the 1973 Ways and Means Committee and Congress overall, now that your degree of accuracy has deteriorated to a plus or minus 5.32 percent, it would now be OK to err on the side of a deficit of 5.32 percent in the program?

Mr. CARDWELL. No, sir.

Mr. ARCHER. Well, that was the logic on which the Congress in 1973 acted to bring about a big part of the problem that we have got today. What I hope is that you and your people will stand up and point out these types of things when the Congress deliberates in the future. There are a few of us in the minority that would like to have some support for what is sound logic with respect to the social security program from people that know what is happening and what is going on.

Mr. CARDWELL. We will do our best to sharpen issues and lay before those who make decisions what information we have, and when asked will give our opinion.

Mr. ARCHER. OK. At one time some of the reports prepared by your actuaries anticipated changes in the cost of the program, and I wonder if you could provide for the record a revision showing each, the cost of change, along with a paragraph or two on each change showing the reason for the changes.

Mr. CARDWELL. Yes; we would be glad to.

[The information follows:]

HISTORY OF ACTUARIAL ESTIMATES OF THE COST OF THE OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROGRAM

INTRODUCTION

This statement is intended to provide a brief history of the long-range "actuarial cost estimates" that have been prepared for the old-age, survivors, and disability insurance program. This history is summarized in numerical form in table 1.

Customarily the Congress has judged the financial stability of the old-age, survivors, and disability insurance program on the basis of its estimated long-range "actuarial balance". This is defined as the difference between the expected average future income to the program and the expected average future outgo from the program expressed as a percent of all earnings that are subject to social security taxes.

Originally the cost projections and the related actuarial balance were prepared over perpetuity on the basis of the assumptions that average earnings would remain level in the future. Following the recommendations of the 1965 Advisory Council on Social Security Financing the period of valuation was later on reduced to 75 years. Due to the enactment of the automatic adjustment provisions in 1972 the estimates have been prepared since then on dynamic assumptions.

Before 1972 the costs and taxes were estimated as the ratio of their present value to the present value of future earnings subject to social security taxes. After 1972 the costs and taxes have been estimated as the arithmetic average of their annual ratios to the earnings subject to social security taxes.

The brief discussions that follow are limited to the period after 1950, since only minor changes in the program were enacted in the 1940's. These discussions cover only those changes that were most important from a long-range cost point of view. More detailed discussion may be obtained from the annual reports of the Board of Trustees of the old-age, survivors, and disability trust funds or from the actuarial reports that have been prepared for and published by the House Committee on Ways and Means at the time of enactment of various amendments in the past.

Actuarial status after enactment of 1950 Act

In connection with the 1950 Act, the Congress stated the belief that the program should be completely self-supporting from the contributions of covered workers and employers. In that Act substantial changes were incorporated in the program: the benefit formula was completely redesigned, and the contribution tax schedule was also substantially revised to finance these changes, as well as to cover the actuarial deficit that had been estimated under the previous Act. After the enactment of these changes the program was found to be in substantial actuarial balance, that is, the long-range future income was estimated to be close to the long-range future outgo.

Actuarial status after enactment of 1952 Act

The actuarial balance under the 1952 Act was estimated, at the time of enactment, to be virtually the same as in the estimates made at the time the 1950 Act was enacted, as shown in table 1. This was the case, because the estimates for the 1952 Act took into consideration the rise in earnings levels in the 3 years preceding the enactment of that Act. This factor virtually offset the increased cost due to the benefit liberalizations that were made. New cost estimates made two years after the enactment of the 1952 Act indicated that the future cost of the benefit disbursements and administrative expenses was somewhat more than 0.5 percent of payroll higher than the scheduled taxes.

Actuarial status after enactment of 1954 Act

Under the 1954 Act, the increase in the contribution schedule met all the additional cost of the benefit changes that were made at that time and also reduced substantially the actuarial imbalance that the then current estimates had indicated in regard to the financing of the 1952 Act.

Actuarial status after enactment of 1956 Act

The estimates for the 1954 Act were revised in 1956 to take into account the rise in the earnings level that had occurred since 1951-52, the period that had been used for the earnings assumptions for the estimates made in 1954. This reduced the actuarial imbalance under the 1954 Act to -.16 percent of taxable payroll. The benefit changes made by the 1956 amendments were fully financed by the increased contribution income provided. Accordingly, the actuarial balance of the program was not substantially affected.

Following the enactment of the 1956 legislation, new cost estimates were made which showed that benefit expenditures were running considerably higher than had previously been estimated and that retirement rates had risen. These cost estimates, which were prepared in early 1958, indicated that the program was out of actuarial balance by somewhat more than 0.4 percent of payroll.

Actuarial status after enactment of 1958 act

The 1958 amendments recognized this situation and provided additional financing for the program—both to reduce the lack of actuarial balance and also to finance certain benefit liberalizations. This was accomplished by introducing an immediate increase (in 1959) in the combined employer-employee contribution rate, amounting to 0.5 percent and by advancing the subsequently scheduled increases in that rate so that they would occur at 3-year intervals (beginning in 1960) instead of at 5-year intervals.

The revised cost estimates made in 1958 for the disability insurance program were based on assumptions that recognized the actual experience, emerging from the program as opposed to the original assumptions which were largely based on judgment. As a result, the moderate actuarial surplus originally estimated was increased somewhat, and most of this was used in the 1958 amendments to finance certain benefit liberalizations, such as inclusion of dependents benefits and modification of the insured status requirements.

Actuarial status after enactment of 1960 act

At the beginning of 1960, the cost estimates for the old-age, survivors, and disability insurance program were reexamined and modified. The earnings assumption had previously been based on the 1956 level, and this was changed to reflect the 1959 level. Also, data first became available on the detailed operations of the disability provisions for 1956, which was the first full year of operation that did not involve picking up "backlog" cases and, accordingly, revised assumptions were made in this regard. As a result it was possible to incorporate the 1960 amendments without modifying the financing provisions.

Actuarial status after enactment of 1961 Act

The changes made by the 1961 amendments involved an increased cost that was fully met by the changes in the financing provisions (namely, an increase in the combined employer-employee contribution rate of 0.25 percent, a corresponding change in the rate for the self-employed, and an advance in the year when the ultimate rates would be effective—from 1969 to 1968). As a result, the actuarial balance of the program remained unchanged.

Subsequent to 1961, the cost estimates were further reexamined. The earnings assumption was changed to reflect the 1963 level, and the interest-rate assumption was modified upward. At the same time, the retirement rate assumptions were increased. The further developing disability experience indicated that costs for this portion of the program were significantly higher than previously estimated (because benefits were not being terminated by death or recovery as rapidly as had been originally assumed). Accordingly, the actuarial balance of the disability insurance program was shown to be in an unsatisfactory position. This was recognized by the Board of Trustees, who recommended that the allocation to this trust fund should be increased (while, at the same time, correspondingly decreasing the allocation to the old-age and survivors insurance trust fund, which under the law in effect at that time was estimated to be in satisfactory actuarial balance after such a reallocation).

Actuarial status after enactment of 1965 Act

The changes made by the 1965 amendments involved an increased cost that was closely met by the changes in the financing provisions (namely, an increase in the contribution schedule, particularly in the later years, and an increase in the earnings base). The actuarial balance of the program remained virtually unchanged.

In 1966, the cost estimates for the old-age, survivors, and disability insurance program were completely revised. The new estimates showed significantly lower costs for the old-age and survivors insurance portion of the program, but higher costs for the disability insurance portion. The factors leading to lower costs were as follows: (1) the use of 1966 earnings level, instead of the 1963 level; (2) an interest rate of 3½ percent for the intermediate-cost estimate, instead of 3½ percent; (3) an assumption of greater future participation of women in the labor force; (4) an assumption of lower improvement in future mortality than had previously been assumed; and (5) an assumption that, despite a significant decline in future fertility rates, such decline would not occur as rapidly as had been assumed previously.

The cost of the disability insurance program was estimated to be significantly higher, as a result of increases in the disability prevalence rates.

Actuarial status after enactment of 1967 Act

The changes made by the 1967 amendments involved an increased cost that was fully met by the actuarial surplus then existent and by the changes in the financing provisions that were adopted (namely an increase in the contribution rate schedule, particularly in the later years, and an increase in the earnings base). As a result the program was almost exactly in actuarial balance (namely a small actuarial surplus of 0.01 percent of taxable payroll).

In 1968, the cost estimates for the old-age, survivors, and disability insurance program were completely revised. The new estimates showed significantly lower costs for the old-age and survivors insurance portion of the program, but slightly higher costs for the disability insurance portion. The factors leading to lower cost were as follows: (1) the use of 1968 earnings level, instead of 1966 level; (2) an interest rate of 4¼ percent, instead of 3¾ percent; and (3) an assumption of greater future participation of women in the labor force.

In 1969, the cost estimates were completely revised. The new estimates indicated that the program was substantially overfinanced. The actuarial surplus was found to be 1.16 percent of taxable payroll. All of this surplus occurred in the old-age and survivors insurance portion, which was estimated to have a surplus of 1.17 percent of taxable payroll. The disability insurance portion was found to have improved financially to the point where it was almost in exact actuarial balance (namely a small deficit of 0.01 percent of taxable payroll). The factors that resulted in lower cost estimates were as follows: (1) use of 1969 earnings level, instead of 1968 level; (2) an interest rate of 4¾ percent, instead of 4¼ percent; and (3) an assumption of higher labor force participation rates for women.

Actuarial status after enactment of 1969 Act

The 1969 amendments increased benefits by 15 percent and the minimum benefit to \$64 per month. These changes fully exhausted the previously estimated actuarial surplus and the program was then in close actuarial balance.

In 1970, the cost estimates for the old-age, survivors, and disability insurance program were completely revised. The new estimates showed significantly lower cost for both the old-age and survivors insurance portion and the disability insurance portion. The lower costs resulted from: (1) the use of 1970 earnings level, instead of 1969 level; (2) an interest rate of $5\frac{1}{4}$ percent, instead of $4\frac{1}{4}$ percent; and (3) an assumption of higher labor-force participation rates for women.

Actuarial status after enactment of 1971 Act

The 1971 amendments increased benefits by 10 percent and made the increase applicable in full to future beneficiaries (including those affected by the family maximum) as well as to the then present beneficiaries. The taxable earnings base was increased to \$9,000 and the ultimate contribution rate was increased to 10.3 percent on a combined employer-employee basis. After these changes the program was in close actuarial balance (there was a small actuarial deficit equivalent to 0.10 percent of taxable payroll).

New estimates prepared in January 1972 indicated that the program was still in close actuarial balance but that it then had a small actuarial surplus of 0.05 percent of taxable payroll. This was the net result of (1) changing to 1971 earnings level, instead of 1970 level; (2) higher retirement and disability rates; (3) updated factors in other respects.

Actuarial status after enactment of Public Law 92-336 in July 1972

The amendments in P.L. 92-336 increased benefits by 20 percent. The taxable earnings base was increased to \$10,800 in 1973 and to \$12,000 in 1974. Both the benefits and the taxable earnings base were made subject to periodic automatic adjustments after 1974.

In accordance with the recommendations of the 1971 Advisory Council on Social Security, the actuarial methodology was modified to incorporate assumptions of increasing average earnings and increases in benefits. This modification in methodology changed the estimated long-range financial status of the system from a basic closeness in the actuarial balance to a significant actuarial surplus. This surplus was used to finance the 20 percent increase in benefits that was enacted.

After these amendments, the system had a small actuarial surplus of 0.07 percent of taxable payroll, based on the dynamic cost projections.

Actuarial status after enactment of Public Law 92-603 in October 1972

At the time of enactment of the October 1972 amendments, which provided for various benefits liberalizations, cost estimates showed that the program was in exact actuarial balance.

In 1973, new estimates were prepared for the same act, which showed that benefit expenditures were higher than previously estimated, resulting in an actuarial deficit of 0.32 percent of taxable payroll.

The amendments in P.L. 93-66 enacted in June 1973 did not change the actuarial balance since the liberalizations that were enacted were offset by an increase in the taxable earnings base.

Due to increases in the CPI during the year which were higher than previously assumed the deficit of 0.32 percent of payroll was estimated to increase to 0.76 percent of taxable payroll by the time that hearings were being held on the bill that was later enacted as P.L. 93-233. This estimate has not been included in table 1 since it only represented a modification in the assumed CPI increases in the first year and did not involve updating any other factor used in projecting long-range costs.

Actuarial status after enactment of Public Law 93-233 in December 1973

The amendments in P.L. 93-233 provided for an earnings base of \$13,200 in 1974, and increases in benefits totalling 11 percent (in two stages, 7 percent for March 1974 and the remaining increase for June of 1974) with automatic increases in both thereafter. The actuarial deficit at the time of enactment was estimated at 0.51 percent of taxable payroll.

The 1974 valuation under this law showed an actuarial deficit of -2.98 percent, due primarily to the new population projections based on declining fertility rates, and to increasing disability incidence rates, increasing unemployment rates, and changes in the economic assumptions.

The 1975 valuation under the same law showed an actuarial deficit of -5.32 percent. This increase in the deficit was due primarily to changes in economic assumptions in which annual increases were projected to be 6 percent in average earnings and 4 percent in CPI after 1980, but with higher assumptions used in the 1975-80 period. These higher economic rates are projected to result in benefits that in the future will increase faster than average earnings due to the way in which the automatic adjustments provisions in present law operate. Other factors also changed were demographic assumptions, female labor force participation rates and higher disability rates.

TABLE 1.—HISTORY OF ACTUARIAL ESTIMATES¹ OF THE COSTS, CONTRIBUTIONS, AND ACTUARIAL BALANCE OF THE OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROGRAM AS PERCENT OF TAXABLE PAYROLL²

Legislation	Date of estimate	Benefit costs ³	Contributions ⁴	Actuarial balance ⁵
Old-age, survivors, and disability insurance: ⁶				
1935 act.....	1935	5.36	5.36	0.00
1939 act.....	1939	5.22	5.30	+ .08
1939 act (as amended in the 1940's) ⁷	1950	4.45	3.98	- .47
1950 act.....	1950	6.20	6.10	- .10
1950 act.....	1952	5.49	5.90	+ .41
1952 act.....	1952	6.00	5.90	- .10
1952 act.....	1954	6.62	6.05	- .57
1954 act.....	1954	7.50	7.12	- .38
1954 act.....	1956	7.45	7.29	- .16
1956 act.....	1956	7.85	7.72	- .13
1956 act.....	1958	8.25	7.83	- .42
1958 act.....	1958	8.76	8.52	- .24
1958 act.....	1960	8.73	8.68	- .05
1960 act.....	1960	8.98	8.68	- .30
1961 act.....	1961	9.35	9.05	- .30
1961 act.....	1963	9.33	9.02	- .31
1961 act (perpetuity basis).....	1964	9.36	9.12	- .24
1961 act (75-yr basis).....	1964	9.09	9.10	+ .01
1965 act.....	1965	9.49	9.42	- .07
1965 act.....	1966	8.76	9.50	+ .74
1967 act.....	1967	9.72	9.73	+ .01
1967 act.....	1968	9.32	9.85	+ .53
1967 act.....	1969	8.72	9.88	+1.16
1969 act.....	1969	9.96	9.88	- .08
1969 act.....	1970	9.60	9.94	+ .34
1971 act.....	1971	10.27	10.17	- .10
1971 act.....	1972	10.16	10.21	+ .05
July 1972, Public Law 92-336.....	1972	9.77	9.84	+ .07
October 1972, Public Law 92-603.....	1972	10.63	10.63	.00
1972 act.....	1973	10.95	10.63	- .32
June 1973, Public Law 93-66.....	1973	10.95	10.63	- .32
December 1973, Public Law 93-233.....	1973	11.39	10.88	- .51
1973 act.....	1974	13.89	10.91	-2.98
1973 act.....	1975	16.26	10.94	-5.32

¹ Estimates prepared before 1964 are on a perpetuity basis, while those prepared after 1964 are on a 75-yr basis. The estimates prepared in 1964 are on both bases. Estimates prepared before 1972 are based on level earning assumptions while those prepared after 1972 are based on dynamic assumptions.

² Taxable payroll is defined as the total of all earnings subject to social security taxes. It includes adjustment to reflect the lower contribution rate on self-employment income and on multiple-employer excess wages as compared with the combined employer-employee rate.

³ These are averages of the expected future benefit payments and administrative expenses as a percent of earnings subject to social security taxes. They include adjustments for the net cost of the financial interchange with the railroad retirement system.

⁴ These are averages of the expected future contributions from employers and employees combined expressed as a percent of earnings subject to social security taxes.

⁵ These are the differences between the benefit costs and the contributions. A negative figure indicates a deficit. A positive figure indicates a surplus.

⁶ The disability insurance program was inaugurated in the 1956 act so that all figures for previous legislation are for the old-age and survivors insurance program only.

⁷ The major changes were in the revision of the contribution schedule; as of the beginning of 1950, the ultimate combined employer-employee rate scheduled was 4 percent.

Mr. ARCHER. And, on another subject, could you briefly explain to us the relationship, of the deficit to the Federal budget.

Mr. CARDWELL. Well, estimates prepared for the Federal budget for the fiscal year 1976 forecast a deficit for that fiscal year of about \$4 billion.

The conclusions of the Board of Trustees are expressed on both a fiscal-year and a calendar-year basis. It would be somewhat higher than the \$4 billion in the budget—close to \$5 billion for fiscal year 1976.

Mr. BURKE. Before I recognize Mr. Pickle, I am not asking any questions today. I expect to ask some questions later. But I have been studying the Trustees report. There is something here that startles me. That is the appendix table D, with respect to increases in average retirement benefit at award, and in current payment status as compared with projected increases for selected years from 1975 to the year 2050.

Now, I know we are not going into the long-range subject in depth today but it looks like it might have come out of the book "Future Shock."

Mr. CARDWELL. Yes.

Mr. BURKE. In the year 1975 in current payment \$2,603. And for the year 2050, social security benefits would be \$312,401 a year. Do you mean that the future beneficiaries have got that to look forward to?

Mr. CARDWELL. In terms of a benefit?

Mr. BURKE. Yes.

Mr. CARDWELL. But by the time you get to some of those high figures, I hate to tell you what a loaf of bread might cost. This really illustrates the result of making such long-term projections in dollar amounts. And I challenge the question of their relevance to what we now understand.

It is hard for a person, I think, to accept the idea that by the year 2025 we would be talking about an average annual level of retirement benefits of about \$365,000. But we would have had as hard a time or as difficult a time sitting back in the year 1875 and perceiving today's costs of living and prices and salaries and wages. It is really all kind of the same thing. And we really excite ourselves, I think, by portraying large figures and then reacting to them.

Mr. BURKE. I know that some people being born this year and with the chance of living 75 years certainly would get excited if they thought about \$312,000 in social security.

Mr. CARDWELL. It is like compound interest; just compound, compound, compound, and that is what happens. I would suggest, Mr. Chairman, if we could review the charts that we would be highlighting some of the points that you are really interested in getting to.

Mr. BURKE. I think that is why it is important for the committee at this time, during the coming months to dwell entirely on the short-term problems and make sure that we stabilize the fund, insure the benefits, work along that line.

Mr. Pickle.

Mr. PICKLE. Well, Mr. Chairman, I will limit my questions briefly because I know he wants to show the charts and I know that we need to be in another committee, too. Permit me just two or three questions.

You say that we really have no danger until about 1980, that we can use reserves. Have you given us an estimate of what are the reserves that we have, is that indicated?

Mr. CARDWELL. I will show that to you today.

Mr. PICKLE. In the chart?

Mr. CARDWELL. Yes. The actual amount today is approximately \$46 billion, and that represents about 66 percent of 1 year's benefits.

Mr. PICKLE. When you made reference on page 3 of your testimony to assets of OASDI funds amount to about \$46.1 billion, that is the reserves?

Mr. CARDWELL. That is the reserves, yes, sir.

Mr. PICKLE. By assets you mean reserves?

Mr. CARDWELL. Yes, sir.

Mr. PICKLE. You say that even though we have got a \$3 billion deficit this year, and it will go up to about \$7 billion by 1979, you said \$8 billion by 1980, we don't need to act before 1980?

Mr. CARDWELL. Well, I won't go so far to say that. You have a margin of safety but should act earlier.

Mr. PICKLE. Do you have any specific recommendations at this time; that is, do you make any recommendations about should we depart from the CBI, should we change that percentage, should we freeze it, should we not make it a part of the law, or should we continue it at present levels?

Mr. CARDWELL. No, sir, I do not have any specific recommendation at this time. I observed for Mr. Archer when he raised the same general question that it is my understanding that the administration's policy as of this moment is to support the continuation of an indexed benefit arrangement. At the same time, though, we would recommend to the Congress, in fact urge the Congress, to consider a revision in the effect of that system, the indexing system, on future benefits for current workers.

And that is this matter of revising the benefits structure so as to stabilize it around the concept of predetermined replacement rates. My purpose today really is to present to you the foundation and the basic information that we believe you need in order to understand the problem, its dimensions, and specifically present to you the findings and commentaries of the Board of Trustees.

I would expect that later when we are back up with the Secretary of HEW and other administration officials that we would be presenting to you in some greater detail some of our specific recommendations and ideas.

Mr. PICKLE. I have no question, but I make the observation, though, that I think we should all, as Members, be cautious not to reach prejudgments about what should be done. That is true of us and it is true of you and it is true of the press, because this is an extremely important part of our society.

Mr. CARDWELL. I will agree.

Mr. PICKLE. So I think we must be careful. I think also, though, that unless we give to the American people a clear direction of conservatism or stability in the financing of this fund, that this program may get in great jeopardy.

We could get so busy not reaching quick, hasty judgments and proceeding with deliberate speed, or deliberate slowness, we would do ourselves a great injustice. We should attack this problem very quickly.

There is a national scare afloat that this program is broke. You are saying it is not, but you are telling us you are going to be \$3 billion to \$7 billion short for the next 7 years. The public is going to think you ought to be gored for hollering when you make statements like that.

Mr. CARDWELL. I have had several members of the public tell me just that.

Mr. PICKLE. So at this point the average worker, the employee, kind of resents paying into the fund, because he is paying more social security tax than he is income tax.

Mr. CARDWELL. Some are.

Mr. PICKLE. Some are. And a lot more of them think that this is building up more and more. Just suddenly it has dawned on them, and a lot of people, the younger ones, are having great skepticism.

So, for us to say we have 5 years to fiddle with this solution is not an appropriate statement, in my opinion. I don't think you intended to convey that.

Mr. CARDWELL. No, sir.

Mr. PICKLE. You say that by 1980 we would be in big trouble.

Mr. CARDWELL. No, sir, I would go back.

Mr. PICKLE. There is big trouble now if we don't promote some legislation?

Mr. CARDWELL. I would agree with the chairman's view that the executive and legislation branches should concentrate immediately on a resolution of the short term problem. It does not mean that that resolution would necessarily require a specific action today. It might require an action several years from now. But portraying to the public a positive decision as to what to do and when to do it is important, and we feel just as the chairman does in that regard.

Mr. PICKLE. Thank you, Mr. Chairman.

Mr. BURKE. I think I can assure Mr. Pickle and the Commissioner and members of the committee and the press that this committee is going to act, and we are going to act this year, on the short-range problem. We will come up with legislation that will insure the stability of the social security fund, to make sure that the benefits are paid, that taxpayers who are paying the taxes in will not be alarmed.

I think the soundness of the social security fund is pretty well established over the years. I don't know now many billions of dollars it loaned out to the Government, but it runs in the hundreds of billions of dollars, and any fund that could loan out that much money over 35 years shouldn't be concerned about some alarming statements that have been made as a result of a \$3 billion deficit for this year. This could happen under any economy and nobody can predict, as I say, 3 years ahead.

Now, it is going to be necessary for Congress in the years to come to keep an eye on the social security trust funds, how they are expended, how they are increased and how the taxes are raised. It is a continuing process. And I don't think that anybody is going to postpone for 5 years or 10 years the problems that are confronting us.

I have a great faith and confidence in every member of this subcommittee and a great faith and confidence in the Ways and Means Committee and our chairman, Mr. Ullman. And I have great faith in Mr. Cardwell.

Mr. CARDWELL. Thank you, sir.

Mr. BURKE. And I have faith in the other people in Health, Education, and Welfare that we can come up with the answer, and we have to come up with the answer—that is our responsibility. They may be unpleasant answers but if they are unpleasant that is what we are here with. You have to take the heat or get out of the kitchen, and I have been able to stand an awful lot of heat over my lifetime.

Mr. CARDWELL. Mr. Chairman, I don't know whether it would help or not, but not everybody realizes that there have been deficits in the past. I can't recite them to you offhand, but there have been several. They have all been relatively minor, but they have all reflected a change of circumstances of a given point in time.

Mr. PICKLE. You are not implying that our deficit now is an unusual set of circumstances. If that were so, it wouldn't grow. You have already said it is going to grow for the next 5 years or so.

Mr. CARDWELL. What is unusual is this forecast of a long-range deficit. There have been short-term deficits in the past that have been allowed to run for a year or so. For example, there were deficits for several years in the late 1950's and early 1960's. Details of this can be found in earlier trustee's reports. I think I am guilty of having implied to people that this had never happened before, this short-term deficit, but I looked at the facts and I find that it has happened before.

Mr. ARCHER. How many months' benefits do you feel should be in the fund?

Mr. CARDWELL. Well, that is certainly a judgmental matter. As we go through the data we will show you, you will find that they start out now at about two-thirds of a year's benefits. By 1977, the end of 1977, it would be down to about a third, and start dropping at a faster rate each year.

I kind of like the idea of a third as being the point at which I would try to start building the fund back up. But that is a judgmental matter and I would expect that the executive branch should give you its views, organized views about it, and I would expect that you should reach your own views about it.

Mr. ARCHER. The Advisory Council has recommended 1 year's benefits. Do you not agree with that?

Mr. CARDWELL. The 1975 Advisory Council didn't recommend a specific level.

Mr. ARCHER. I am not talking about this year.

Mr. CARDWELL. The 1971 Advisory Council did recommend a reserve equal to a year's benefits. I think that was an arbitrary and judgmental matter at that time. The 1975 Advisory Council examined that question and said they didn't think a full year's reserves were necessary, in fact, that they might even prove over a period of time to be an excessive accumulation. They didn't specify any particular level.

Mr. ARCHER. You know, it seems to me that that is exactly the kind of thinking that has got us to the trouble that we are in today. If we had adopted a provision 2 or 3 years ago that 6 months would have been enough, we would be in real serious trouble today. It is only because the previous Advisory Councils did say it ought to be at a year, and Congress held it at a year, that we are able to have the running room to pull our way out of this.

Mr. CARDWELL. It has not been a year, I believe, for quite a while.

Mr. ARCHER. I know it, but the target was always to shoot at a year. Now you are telling us that is too much to shoot at, and that is exactly what you have indicated to be less accuracy in projections. That is going to get us in a lot of trouble down the line, it seems to me. I would think that you people, of all people, should say we ought to have a goal of at least 1 year's benefits.

Mr. CARDWELL. I was not privy to the deliberations of the Council that led to the idea of a year. They said 1 year's benefits plus-or-minus 25 percent. But I think it was in part a figure designed to assure public confidence in the program. It is not really necessary to have a fund of that size for it to serve its contingency reserve role. For this purpose it is only necessary to have available an amount sufficient for periods of adverse economic conditions.

I don't think anyone would predict 15-percent unemployment, or zero inflation, but within a range you can predict fairly accurately what the absolute dollar amount needed for contingencies is, and that is what you really ought to go by.

We talked a moment ago about the idea of a third. One reason I fasten on a third for this point in time is that in my look at the years 1978 and 1979 I see us getting dangerously close to what would look like a reasonable absolute dollar amount needed to protect the system. It is a matter of judgment, but I think this is a reasonable, minimum level. You also have to weigh other factors as well. Given today's circumstances, I think the general state of the economy itself deserves some serious consideration. Would we want to increase revenue development immediately just in order to have that hundred percent, which I consider to be an arbitrary figure? I would suggest not.

Mr. ARCHER. Well, that is exactly the reason why we should have been shooting at a year when we were in prosperous times. If we shoot for a third when we are in prosperous times, and we get to a point where the economy couldn't bear it, you say all of a sudden now we have to put it back up.

Mr. CARDWELL. No. I am not advocating a third in prosperous times. I am saying a third might be a point at which to draw the line, and I wouldn't allow it to drop below a third and would take steps to build it back up again.

Mr. ARCHER. Let me ask you quickly, why are disabilities up so dramatically?

Mr. CARDWELL. Well, I wish I had an exact answer. The record shows that disability claims and benefit awards are increasing at a faster rate than earlier estimates. When the private insurance industry went into disability insurance they had exactly the same experience. They did not accurately predict the rate at which people would become sufficiently disabled to lay a claim.

What we have reflected in this board of trustees' report is our most recent experience.

Many people believe that a correlation can be found between the rate of disability claims and changes in the economy. During periods of high unemployment, people who would ordinarily struggle to work even though disabled lose their jobs and then claim their benefit right, and so forth. But I would say to you that we really do not have such finely tuned data that we could tell you exactly why the disability rates are increasing. The phenomena that we are experiencing is that it is a growing caseload.

Speaking of leveling with the Congress, I am going to perhaps go farther than I should. It is my judgment that Congress and the public policymakers involved in this program and its development through the years have wanted it to be a program that would not cost so much and that we have worked and worked and worked at ways to avoid the costs of the program, and I think we have had a tendency to understate it. I think disability insurance is an expensive program, and will always be an expensive program, and we had better face up to it.

Mr. ARCHER. Well, that is exactly the kind of testimony that we need to get from people who have the responsibility on a day-to-day basis of looking after this social security program. But in 1973 your Trustees reported, "The Social Security Administration has set up a comprehensive study to look into recent increases in disability rates and the study should be expedited." That is quote-unquote from 1973.

In 1974 the trustees report stated, "A more complete knowledge of possible future trends in the number of disabled worker beneficiaries will not be available until the current study of recent increases is completed," quote-unquote.

Now, in 1975 you say, "A more complete knowledge of possible future trends in the number of disabled worker beneficiaries will not be available until the current study on recent increases is completed."

Now, are we just going to get another sequel of this every year, or are we going to get in and find out what is happening here?

Mr. CARDWELL. Well, there are studies on top of studies on top of studies on these questions, the most significant of which actually is one which was sponsored by this committee and was just completed during 1974 in conjunction with the Library of Congress staff. It is a very elaborate, a very extensive study. I am not very expert at this subject myself. I haven't been associated with it for that long. But my general feeling is that these studies, no matter how well we pursue them, aren't really turning out the answers.

Meaningful information about medical conditions, behavioral attitudes, and responses to changing economic and social conditions is very difficult to develop. We keep making stabs at them. We do analyses of people who are turned down, to find out what happened to them after they were turned down. Did they later become disabled, did they come back onto the rolls.

The staff study that was done by the Library of Congress for the committee suggested that if we went back to more stringent review techniques we could affect the rates, and so on, and so on, and so on. I think as I said earlier we are kind of looking for the answer we want. And the answer we want is that we know a lot about how the population will behave. I have talked to insurance company executives and they tell me they have had exactly the same problems, and they are in for a profit and they care an awful lot about being able to predict accurately what will happen in a future circumstance relative to disability, and they have also had a great deal of difficulty on this.

Mr. ARCHER. Well, it seems—

Mr. BURKE. I think on May 21 we are going to go into the disability problems, the administrative problems and get some information.

Mr. ARCHER. OK, if we are going to go into that detail, Mr. Chairman, I won't.

Mr. BURKE. The Committee staff reviewed the problems of disability in depth last year.

Mr. CARDWELL. It is the most extensive review anybody has done, to my knowledge, and I would commend it to you.

Mr. BURKE. On the 21st we will take it up. Are there any further questions?

We want to thank you very much, Commissioner, for coming here today.

I am glad that you agree with me on the fact of the soundness of the Social Security Trust Fund, and the fact that the American people felt really concerned about it. We are very concerned ourselves.

Mr. CARDWELL. Thank you, Mr. Chairman.

Mr. BURKE. And without objection, we will insert your entire statement in the record.

Mr. BURKE. The committee will now adjourn until May 14.

Mr. CARDWELL. Mr. Chairman, since I feel I carried my base viol all the way across town and didn't get to play, could we put the charts into the record, too, as part of the statement?

Mr. BURKE. Yes, the charts appended to your statement, together with the trustee's report on the OASDI trust funds, will be included.

Mr. CARDWELL. Thank you very much.

[The prepared statement and material referred to follow:]

STATEMENT OF JAMES B. CARDWELL, COMMISSIONER OF SOCIAL SECURITY

Mr. Chairman and members of the subcommittee, I appreciate this opportunity to present to you the 1975 reports of the Boards of Trustees of the Social Security Trust Funds. As you know, the Commissioner of Social Security is *ex officio* Secretary of the Board, and while I regret that members of the Board are unable to be here today, I will do my best, on behalf of the Trustees, to present highlights of the Board's reports and to try to answer your questions.

I would note at the outset the fact that this is my first appearance before the newly formed Subcommittee on Social Security. Both as Commissioner of Social Security and as Secretary of the Board of Trustees, I would take this opportunity, Mr. Chairman, to express the willingness of the Department of Health, Education, and Welfare, the Social Security Administration, and the Board to cooperate with this Subcommittee and its work in every way possible. It is our hope that, through your Subcommittee, we can continue the strong working relationship that has been developed over the years between the Executive Branch and the full Committee.

I would like to begin the discussion by briefly reviewing the major features of the Trustees' reports, after which I would propose to go into a detailed review of the future financial status of the system, particularly the cash benefits program. To facilitate the presentation of the details, I have a few charts which I will turn to at the end of my statement. Since a discussion of the Trustees' reports necessarily involves a recitation of figures, I cannot avoid presenting an array of them in my statement, but I would remind you that the *key* figures will be before you again in the charts.

HIGHLIGHTS OF THE TRUSTEES' REPORTS—1974 ACTIVITY

Several changes in the law affected the operations of the cash benefits trust funds during fiscal year 1974. A general benefit increase of 11 percent enacted in 1973 became effective (in two steps) during the year, and the annual exempt amount of earnings under the retirement test increased from \$2,100 to \$2,400 for calendar year 1974. (This has since been increased to \$2,520 for 1975 under the automatic adjustment provisions of the law.) The OASDI contribution rate was increased from 4.85 percent for employees and employers, each, to 4.95 percent, each, on January 1, 1974, and the contribution and benefit base was increased from \$10,800 to \$13,200, effective January 1, 1974.

Income to the social security OASDI program during fiscal year 1974 amounted to \$57.7 billion, an increase of \$8.1 billion over fiscal year 1973. Total outgo was \$55.9 billion, an increase of \$6.8 billion over fiscal year 1973. At the end of fiscal year 1974, the assets of the OASDI trust funds amounted to \$46.1 billion, as compared with \$44.3 billion at the end of fiscal year 1973. The number of contributors grew from 96 million to 101 million and the number of beneficiaries increased from 29.1 million at the end of fiscal year 1973 to 30.2 million at the end of fiscal year 1974.

Income to the Medicare hospital insurance program (Part A) in fiscal year 1974 totaled \$11.6 billion, compared with \$8.4 billion in fiscal year 1973. Outgo grew from \$6.8 billion in fiscal year 1973 to \$8.1 billion in fiscal year 1974. The assets of the hospital insurance trust fund grew by \$3.5 billion, to \$7.9 billion, during fiscal year 1974. Income to the supplementary medical insurance (Part B) program amounted to \$3.8 billion in fiscal year 1974, up from \$2.9 billion in fiscal year 1973. Supplementary medical insurance outgo was \$3.3 billion in fiscal year 1974, an increase of \$0.7 billion over fiscal year 1973. The assets of the supplementary medical insurance trust fund at the end of fiscal year 1974 amounted to \$1.4 billion compared with assets of \$0.7 billion at the end of fiscal year 1973.

CHANGES SINCE LAST TRUSTEES REPORT

Since the 1974 Trustees report was issued there have been several changes in the social security cash benefits program under the automatic adjustment provisions of the law. The first determination of an automatic increase in the contribution and benefit base—to \$14,100—was announced in 1974, effective for January 1, 1975. The retirement test exempt amount was increased automatically to \$2,520, effective for January 1, 1975. Although it is a 1975 event, I would point out that the first automatic cost-of-living benefit increase has been determined, under present law, to 8.0 percent, effective for June 1975. As you know, the President has proposed a 5-percent limit on this automatic increase and Secretary Weinberger has recently restated the Administration's interest in seeing this limit enacted. However, the Trustees in their review of the status of the program under present law did not, of course, assume any *ad hoc* congressional action with regard to this year's benefit increase. Their forecasts for 1975-76 are based on current law.

THE FUTURE FINANCIAL STATUS OF THE OASDI PROGRAM

Under projections of both the short- and long-range financial status of the OASDI program, as shown in the trustees' report, expected expenditures will exceed income annually beginning this calendar year. As you all are aware, a number of sensational and alarmist articles have appeared in the press in the past few months suggesting that social security has "gone broke." There is simply no justification for such articles. As I will point out today, the system is reacting predictably to the sudden changes that have occurred in the economy, and the funds' reserves provide proper safeguards to insure benefit funding for the next several years, even in the face of trust fund deficits in consecutive years. This is not to belittle the seriousness of the problem but to say that the system's reserves provide adequate time to deal with the situation in a thoughtful and deliberate way.

Short-term financing issues.—With this in mind, let me amplify the short-term financial status of the OASDI program. Under present law, expenditures under the social security old-age, survivors, and disability insurance program will exceed income by about \$3 billion this tax year. Current estimates in the Trustees report show that under present law annual excesses of outgo over income would continue into the future, reaching about \$7 billion in 1979. Clearly we will need to act if we are to prevent depletion of the trust funds in the early 1980's and we are developing specific proposals in this regard.

The current projections are, of course, sharply different from the short-term projections given in last year's Trustees' report. This has obviously been a period in which it has been particularly difficult to forecast accurately changes in the CPI, levels of employment, productivity, and average earnings. And, as you know, the projections of trust fund operations are highly sensitive to forecasts in all these areas.

Since social security benefits are, by law, tied to the Consumer Price Index, higher than anticipated levels of inflation in the short-term future mean higher than anticipated expenditures for social security benefits. At the same time, today's increased levels of unemployment mean less income to the program.

The 1975 Trustees' report assumes, in addition to the previously mentioned 1975 cost-of-living increase of 8.0 percent, future cost-of-living increases of 6.6 percent in 1976, 6.4 percent in 1977, 6.3 percent in 1978, and 4.8 percent in 1979. The assumptions underlying the estimates in the Trustees' report vary from those used in the preparation of the President's 1976 Budget (Page 41 of the President's Budget). We understand that the latter assumptions are being updated and will be provided to the Congress as a part of the mid-term report on the Budget.

The Trustees' report assumes that the average unemployment rate will be 8.8 percent in 1975, 8.0 percent in 1976, 7.0 percent in 1977, 6.2 percent in 1978, 5.4 percent in 1979, and 4.8 percent in 1980.

Long term financial status.—Now let me turn to the long-term financial status of the OASDI program. A brief review of the changes over the past two years in the long-term status of the program will serve as both an introduction to the discussion of the long-range financial status of the program and as an illustration of the sensitivity of such long-term estimates to changes in economic and other assumptions.

As you will recall, the 1973 Trustees' report showed the cash benefits program to have a long-range deficit of only 0.32 percent of taxable payroll. By November 1973, when the Ways and Means Committee was considering the bill which ultimately resulted in the two-stage 11-percent benefit increase that was enacted the following month, the deficit was estimated to be 0.76 percent of taxable payroll. This increase in the deficit was due largely to higher than previously anticipated short-term rates of increases in the CPI.

The financing changes contained in the benefit increase bill (H.R. 11333) that was enacted in December 1973 (P.L. 93-233) reduced the long-range deficit to an estimated 0.51 percent of taxable payroll. (This reduction in the deficit was achieved by increasing the earnings base for 1974 from the \$12,600 scheduled earlier to \$13,200 and by reallocating part of the HI tax rate to the OASDI program.)

When the 1974 Trustees' report was issued a year ago this month, the actuarial deficit was estimated to be 2.98 percent of taxable payroll. The major portion of this increase in the deficit was due to revised fertility projections based on 1970 Census data which became available in 1973. Based on the new demographic projections, the future work force will be considerably smaller in proportion to the number of beneficiaries than was previously anticipated. Today's ratio of about 30 beneficiaries for every 100 workers protected today is projected to increase to about 48 beneficiaries per 100 workers by the year 2030. Thus, proportionately fewer workers will be supporting more beneficiaries and the cost of the program, expressed as a percentage of payroll, will be substantially increased. (I would point out that long-term demographic trends of this sort will not begin to be felt for many years to come; their major impact will not occur until about 2010.) Revised assumptions as to future movements of wages and prices also played a significant role in the 1974 forecast of an increased deficit.

The 1975 Trustees' report estimates the long-range deficit at 5.32 percent of taxable payroll, or 2.34 percent higher than the 1974 estimate. The largest single increment of increase involves new long-range economic assumptions; in fact, the increase in the deficit of 1.95 percent of payroll that is attributable to economic factors accounts for about 83 percent of the 2.34-percent increase in the deficit.

A further factor in the increase in the projected deficit since the last Trustees' report is the increased rate at which disability insurance benefits are being awarded and the length of time disability insurance beneficiaries remain on the rolls.

As you know, the cost of the disability program has been increasing in the last few years and the estimates contained in the 1975 Trustees' report have been updated to reflect actual experience through calendar year 1974 as well as to reflect the assumption that the award rate will continue to increase at 3 percent per year for the next five years.

Wage and Price assumptions.—The central set of long-range economic assumptions used in the Trustees' report is based on annual increases of 6 percent in average earnings and 4 percent in the Consumer Price Index for the period 1981-2049. The Trustees have, however, presented estimates based on alternative long-range assumptions and such estimates are also contained in the report.

In citing these long-range projections, I would emphasize that the effects that they predict will not be felt for many years. It is important to note, I believe, that there is ample time for deliberate consideration of alternative methods of restoring the long-range financial soundness of the program.

One element affecting the long-range financial status of the cash benefits program that deserves particular attention is the combined effect of price and wage increases on future benefits. The benefit adjustment mechanism under present law is extremely sensitive to the movement of prices and wages. Under reasonable projections of rising wages and prices over the long range, benefits in the future could replace a much larger proportion of preretirement earnings than they now do and consequently increase the costs of the program substantially. The Trustees recommend in their report (as did the 1975 Advisory Council on Social Security) that the system be modified so as to maintain a planned, constant, and predictable relationship between benefit levels and the preretirement earnings on which the benefits are based. Modification of the benefit structure in this way holds a great deal of promise for helping to deal with the long-range financial deficit in the program.

As you know, the President has endorsed the general concept of a restructuring of social security benefits so as to provide stable and predictable replacement of preretirement earnings. He has directed the Department of Health, Education, and Welfare and the Domestic Council to study alternative ways of accomplishing this objective, with a view to developing a specific legislative recommendation. We also note that the Ways and Means Committee has joined with the Senate Finance Committee in asking the Library of Congress for a study of proposals along this line. And we are in full cooperation with that effort. Because a benefit stabilization proposal could very significantly affect the long-range financing of the social security program it seems prudent to hold in abeyance the question of dealing with the long-range financial deficit pending development of a specific benefit structure proposal.

With regard to the long-range soundness of the hospital insurance program, the hospital insurance Trustees' report notes that, while substantial excesses of income over outgo are projected for hospital insurance for the short term, there is a very slight (0.16 percent of taxable payroll) long-range deficit in the program.

Alternatives for restoring the short-range soundness of social security.—Since the short-range imbalance is already upon us, it requires more immediate action. For this reason, the Administration is focusing its first attention on the question of how best to restore the short-range soundness of the program. Secretary Weinberger hopes to speak to this subject when he appears before the Subcommittee later this month.

Whatever direction and method of short-term financing to be finally chosen, by the Administration and by the Congress, I believe it is useful to bear in mind some important questions of timing. While legislative action this year could go a long way towards alleviating public fears and restoring public confidence, the state of the economy should be considered before any final decisions are made. The reserves are sufficient to assure adequate time for deliberation, for individuals and organizations to make known their views, and for the Executive Branch and the Congress to act. The point to be made is that revenue development for social security must, as the Trustees point out, be consonant with plans for economic recovery.

Mr. Chairman, that concludes my prepared statement. I will be happy to answer any questions you may have or, if the Subcommittee wishes, I will move on to my chart presentation.

OASDHI CONTRIBUTION RATES UNDER PRESENT LAW EMPLOYER-EMPLOYEE, EACH

YEARS	OASDI	HI	TOTAL
1975-77	4.95%	0.90%	5.85%
1978-80	4.95	1.10	6.05
1981-85	4.95	1.35	6.30
1986-98	4.95	1.50	6.45
1999-2010	4.95	(1.50) ^{1/}	(6.45) ^{1/}
2011 on	5.95	(1.50) ^{1/}	(7.45) ^{1/}

^{1/} LONG-TERM RATES APPEAR IN LAW THOUGH HI COST ESTIMATES ARE MADE FOR ONLY 25 YEARS

NOTE: Rates apply to annual earnings up to contribution and benefit base-- \$14,100 in 1975, automatically increased as general wages rise thereafter

SHORT-RANGE STATUS OF OASDI TRUST FUNDS

OASDI TRUST FUNDS IN THE NEXT FEW YEARS WILL --

- DECLINE AS % OF EXPECTED ANNUAL EXPENDITURES**
- DECLINE IN ABSOLUTE DOLLAR AMOUNTS**

TRUST FUNDS DEPLETED BY EARLY 1980's

ADDITIONAL FINANCING NEEDED WITHIN NEXT FEW YEARS

ESTIMATED SHORT-RANGE OASDI TRUST FUNDS OPERATIONS - (COMBINED) (IN BILLIONS)

YEAR	INCOME	OUTGO	ASSETS*	NET CHANGE	ASSETS* AS % OF YEAR'S OUTGO
1975	\$66.5	\$69.5	\$45.9	\$-3.0	66 %
1976	72.3	78.1	42.9	-5.8	55
1977	81.8	87.5	37.1	-5.8	42
1978	91.1	97.1	31.3	-6.0	32
1979	100.3	107.1	25.4	-6.8	24
1980	109.1	116.8	18.6	-7.7	16

* BEGINNING OF YEAR

**PROJECTED BENEFIT AND EARNINGS BASE INCREASES
UNDER AUTOMATIC PROVISIONS OF PRESENT LAW**

YEAR	JUNE BENEFIT INCREASE	EARNINGS BASE
1975	8.0	\$ 14,100
1976	6.6	15,000
1977	6.4	16,500
1978	6.3	18,300
1979	4.8	19,800
1980	4.0	21,300

LONG-RANGE STATUS OF THE PROGRAM

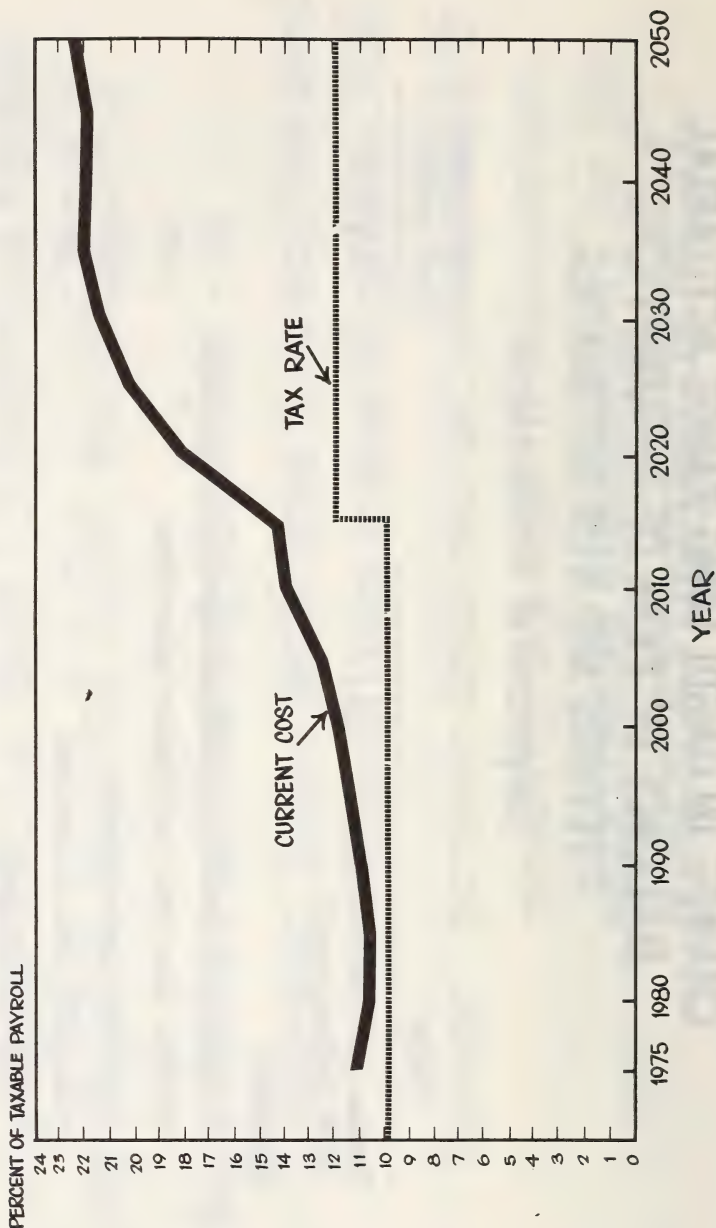
- Long-range deficit is about 5.3 percent of taxable payroll (1974 projected deficit was about 3%).
- Major factors in influencing the deficit
 - Demographic: Ratio of beneficiaries to workers from about 32 per 100 today to about 48 per 100 in 2030.
 - Economic: Increase in deficit since last year due largely to revised long range wage & price assumptions. wages projected to increase at 6% per year, prices at 4% (previously 5% and 3%).

CHANGE IN OASDI LONG-RANGE ACTUARIAL BALANCE BY TYPE OF ASSUMPTION, PREVIOUS AND NEW ESTIMATES (as percent of taxable payroll)

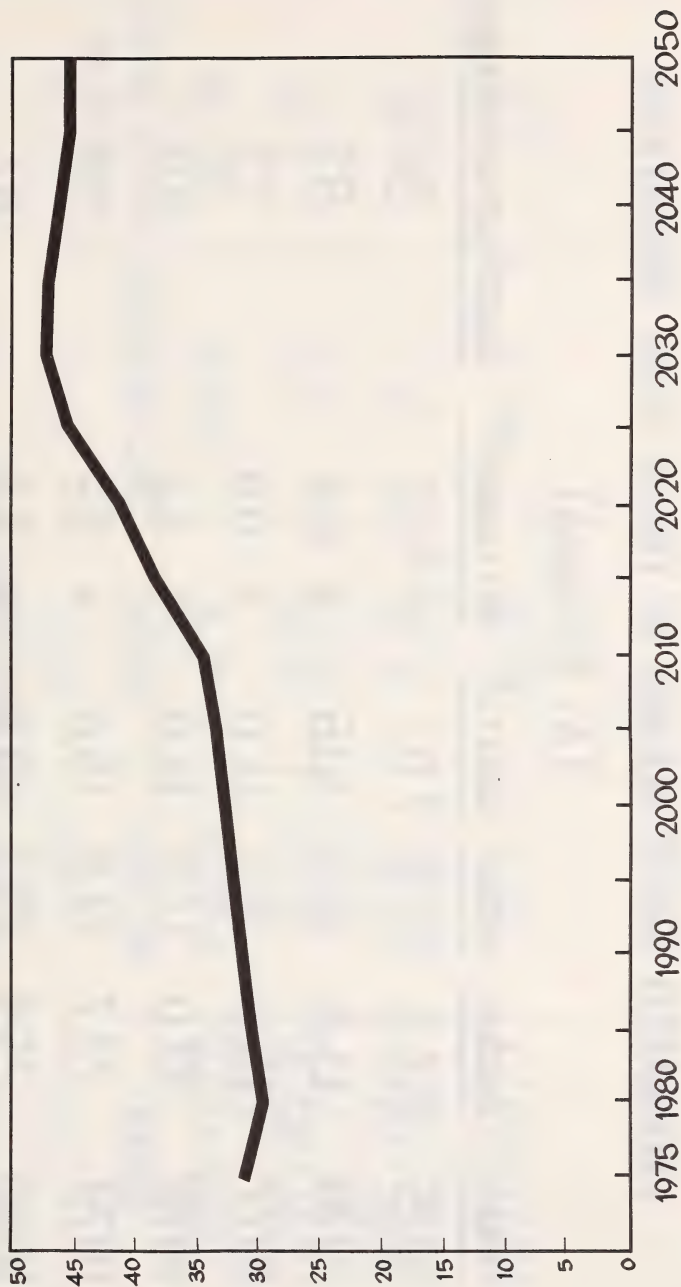
ITEM	LONG-RANGE COST EFFECT
Previous actuarial balance (1974 Trustees report)	-2.98%
CHANGES:	
• Demographic (fertility, mortality and migration) assumptions	-.24
• Female labor force participation assumptions	+.35
• Economic assumptions	-1.95
• Disability rate assumptions	-.60
• Other factors (net)	+.10
<i>Total effect</i>	-2.34
<i>New actuarial balance</i> ^{1/}	-5.32

^{1/}Based on central economic assumptions of 6% annual increases in earnings and 4% annual increases in CPI.

PROJECTED OASDI CURRENT-COST AND TAX RATE IN PRESENT LAW, 1975-2050



PROJECTED OASDI BENEFICIARIES PER HUNDRED COVERED WORKERS 1975 - 2050



ESTIMATED SHORT-RANGE HI TRUST FUND OPERATIONS

(In Billions)

<u>YEAR</u>	<u>INCOME</u>	<u>OUTGO</u>	<u>ASSETS*</u>	<u>NET CHANGE**</u>	<u>ASSETS* AS % OF YEARS OUTGO</u>
1975	\$12.8	\$11.3	\$ 9.1	+\$1.5	81 %
1976	13.4	13.0	10.6	+ 0.4	82
1977	15.9	15.0	11.0	+ 0.9	73
1978	21.0	17.3	11.9	+ 3.7	69
1979	23.7	19.8	15.6	+ 3.9	79
1980	25.9	22.5	19.5	+ 3.5	87

* BEGINNING OF YEAR

** WHILE FUND GROWS OVER SHORT RANGE, LONG-RANGE PROJECTIONS SHOW SLIGHT DEFICIT OF 0.16 % OF PAYROLL

ESTIMATED OPERATIONS OF THE SMI TRUST FUND

(IN BILLIONS)

PERIOD	INCOME	OUTGO	NET INCREASE	ASSETS AT END OF PERIOD
7/74-6/75	\$4.3	\$4.1	\$0.2	\$1.5
7/75-6/76	5.0	4.8	0.2	1.7
7/76-9/76	1.5	1.4	0.1	1.8
10/76-9/77	6.1	5.8	0.3	2.1

SOCIAL SECURITY FINANCING

1966-1975

YEARS	EARNINGS BASE	CONTRIBUTION RATE, EMPLOYER AND EMPLOYEE EACH		
		OASDI	HI	TOTAL
1966	\$6,600	3.85%	0.35%	4.20%
1967	6,600	3.90	0.50	4.40
1968	7,800	3.80	0.60	4.40
1969-70	7,800	4.20	0.60	4.80
1971	7,800	4.60	0.60	5.20
1972	9,000	4.60	0.60	5.20
1973	10,800	4.85	1.00	5.85
1974	13,200	4.95	0.90	5.85
1975	14,100	4.95	0.90	5.85

1975 ANNUAL REPORT OF THE BOARD OF
TRUSTEES OF THE FEDERAL OLD-AGE
AND SURVIVORS INSURANCE AND
DISABILITY INSURANCE
TRUST FUNDS

COMMUNICATION

FROM

BOARD OF TRUSTEES
FEDERAL OLD-AGE AND SURVIVORS
INSURANCE AND DISABILITY INSURANCE
TRUST FUNDS

TRANSMITTING

THE 1975 ANNUAL REPORT OF THE BOARD, PURSUANT TO
SECTION 201(c) OF THE SOCIAL SECURITY ACT, AS
AMENDED



MAY 6, 1975.—Referred to the Committee on Ways and Means
and ordered to be printed

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1975

1975 ANNUAL REPORT OF THE BOARD OF
TRUSTEES OF THE FEDERAL OLD-AGE
AND SURVIVORS INSURANCE AND
DISABILITY INSURANCE
TRUST FUNDS

LETTER
FROM
BOARD OF TRUSTEES
FEDERAL OLD-AGE AND SURVIVORS INSURANCE
AND DISABILITY INSURANCE TRUST FUNDS

TRANSMITTING
The 1975 Annual Report of the Board (35th Report),
Pursuant to the Provisions of Section 201(c)
of the Social Security Act, as Amended

LETTER OF TRANSMITTAL

BOARD OF TRUSTEES OF THE
FEDERAL OLD-AGE AND SURVIVORS INSURANCE
AND DISABILITY INSURANCE TRUST FUNDS,
Washington, D.C., May 2, 1975.

THE SPEAKER OF THE HOUSE OF REPRESENTATIVES,
Washington, D.C.

SIR: We have the honor to transmit to you the 1975 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund (the 35th such report), in compliance with the provisions of section 201(c) of the Social Security Act.

Respectfully,

WILLIAM E. SIMON,
Secretary of the Treasury,
and Managing Trustee of the Trust.

JOHN T. DUNLOP,
Secretary of Labor.

CASPAR W. WEINBERGER,
Secretary of Health,
Education, and Welfare.

JAMES B. CARDWELL,
Commissioner of Social Security.

CONTENTS

	Page
The Board of Trustees.....	1
Highlights.....	1
Nature of the trust funds.....	2
Summary of the operations of the Federal old-age and survivors insurance trust fund, fiscal year 1974.....	6
Summary of the operations of the Federal disability insurance trust fund, fiscal year 1974.....	14
Expected operations and status of the trust funds during the period July 1, 1974, to December 31, 1979.....	19
Actuarial analysis of benefit disbursements from the Federal old-age and survivors insurance trust fund with respect to disabled beneficiaries....	32
Long-range actuarial status of the trust funds.....	34
Advisory Council on Social Security.....	42
Conclusion.....	44
Appendixes:	
A.—Assumptions, methodology, and details of long-range cost estimates.....	47
B.—Determination and announcement of social security contribution and benefit base and retirement test exempt amount for 1975....	57

1975 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE TRUST FUND AND THE FEDERAL DISABILITY INSURANCE TRUST FUND

THE BOARD OF TRUSTEES

The Federal Old-Age and Survivors Insurance Trust Fund, established on January 1, 1940, and the Federal Disability Insurance Trust Fund, established on August 1, 1956, are held by the Board of Trustees under the authority of section 201(c) of the Social Security Act. The Board is comprised of three members who serve in an ex officio capacity. The members of the Board are the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Health, Education, and Welfare. The Secretary of the Treasury is designated by law as the Managing Trustee. The Commissioner of Social Security is Secretary of the Board. The Board of Trustees reports to the Congress once each year, in compliance with section 201(c)(2) of the Social Security Act. This report is the annual report for 1975, the 35th such report.

HIGHLIGHTS

The more important developments since the 1974 annual report, discussed in more detail in later sections, are indicated below:

(a) The growth of the old-age, survivors, and disability insurance system during fiscal year 1974 was close to that predicted in the 1974 annual report. Income in fiscal 1974 amounted to \$57.7 billion, up by 16 percent over fiscal 1973. Outgo totaled \$55.9 billion, 14 percent more than in fiscal 1973. The funds increased by \$1.8 billion in fiscal 1974, to a level of \$46.1 billion on June 30, 1974.

(b) Several changes affecting the operations of the trust funds occurred during fiscal year 1974. A general benefit increase of 11 percent became effective in two steps—the first, an interim increase of 7 percent effective for the 3 months March–May 1974, followed by the full 11-percent increase effective for June 1974. The amount that a beneficiary may earn in a year, and still receive all of his benefits under the retirement test (i.e., the annual exempt amount) increased from \$2,100 to \$2,400 effective January 1, 1974. The contribution rate for old-age, survivors, and disability insurance increased from 4.85 percent each, for employees and their employers, to 4.95 percent each, effective January 1, 1974. The contribution and benefit base also increased, from \$10,800 to \$13,200, effective January 1, 1974. The comparison of trust-fund operations in fiscal year 1974 with operations in fiscal year 1973 is also affected by a 20-percent general benefit increase effective with benefits for September 1972, provided under Public Law 92-336, and by other provisions of Public Laws 92-336 and 92-603, most of which became effective January 1, 1973.

(c) The number of persons receiving monthly benefits under the old-age, survivors, and disability insurance program totalled 30.2 million by the end of June 1974. An estimated 101 million workers had earnings in calendar year 1974 that were taxable and creditable toward benefits under the program.

(d) The trust funds earned interest of \$2.5 billion during the fiscal year, equivalent to an effective annual rate of 6.0 percent on the total assets of the trust funds.

(e) The first automatic increases in the contribution and benefit base and in the annual exempt amount under the retirement test were determined under the automatic increase provisions in the law. The new amounts, effective for January 1, 1975, are \$14,100 and \$2,520, respectively. The published statement announcing the determination of these amounts is shown in Appendix B.

(f) The first automatic cost-of-living benefit increase was determined to be 8.0 percent, effective for June 1975.

(g) In every calendar year beginning with 1975, the projected outlays of the combined old-age and survivors insurance and disability insurance systems are estimated to exceed the tax income according to the scheduled tax rates and estimated future increases in the contribution and benefit base. This annual deficit is estimated to be, on the average, 1.26 percent of taxable earnings over the next 25-year period (1975-1999). The average annual deficit over the second 25-year period (2000-2024) is estimated to be 4.10 percent, and over the third 25-year period (2025-2049) is estimated to be 10.19 percent.

The long-range average-cost when computed in the customary way over the entire 75-year period (1975-2049) exceeds the average tax rate scheduled in present law by 5.32 percent of taxable payroll.

(h) Assets of both the old-age and survivors insurance trust fund and the disability insurance trust fund are estimated to show substantial declines during the 5-year period 1975-79. The estimates indicate that, without legislation to provide additional financing, the assets of both trust funds will be exhausted soon after 1979.

(i) The reports of the 1975 Advisory Council on Social Security were received, and the recommendations that would have a significant impact on the financing of the old-age, survivors, and disability insurance program are being carefully evaluated.

NATURE OF THE TRUST FUNDS

The Federal old-age and survivors insurance trust fund was established on January 1, 1940, as a separate account in the United States Treasury to hold the amounts accumulated under the old-age and survivors insurance program. All the financial operations which relate to the system of old-age and survivors insurance are handled through this fund. The Social Security Amendments of 1956, which became law August 1, 1956, provided for the creation of the Federal disability insurance trust fund—a fund entirely separate from the old-age and survivors insurance trust fund—through which are handled all finan-

cial operations in connection with the system of monthly disability benefits payable to insured workers and to their dependents.

The major sources of receipts of these two funds are (1) amounts appropriated to each of them under permanent appropriation on the basis of contributions paid by workers and their employers, and by individuals with self-employment income, in work covered by the old-age, survivors, and disability insurance program and (2) amounts deposited in each of them representing contributions paid by workers employed by State and local governments and by such employers with respect to work covered by the program. All employees, and their employers, in employment covered by the program are required to pay contributions with respect to the wages of individual workers (cash tips, covered as wages beginning in 1966 under the 1965 Amendments, are an exception to this; employees pay contributions with respect to cash tips, but employers do not). All covered self-employed persons are required to pay contributions with respect to their self-employment income.

In general, an individual's contributions are computed on annual wages or self-employment income, or both wages and self-employment income combined, up to a specified maximum annual amount, with the contributions being determined first on the wages and then on any self-employment income necessary to make up the annual maximum amount.

The contribution rates applicable to taxable earnings in each of the calendar years 1937 and later, and the allocation of the rates to finance expenditures from each of the two trust funds, are shown in table 1. For 1976 and later, the contribution rates shown are the rates scheduled in the provisions of present law. The maximum amount of annual earnings taxable in each year, 1937-75, is also shown in table 1. Beginning with 1975, the maximum amount of earnings taxable in each year is determined in the preceding year under the automatic increase provisions in section 230 of the Social Security Act, unless modified by intervening Congressional action.

Except for amounts received by the Secretary of the Treasury under State agreements (to effectuate coverage under the program for State and local government employees) and deposited directly in the trust funds, all contributions are collected by the Internal Revenue Service and deposited in the general fund of the Treasury as internal revenue collections; then, on an estimated basis, the contributions received are immediately and automatically appropriated to the trust funds. The exact amount of contributions received is not known initially since old-age, survivors, disability, and hospital insurance contributions and individual income taxes are not separately identified in collection reports received by the Treasury Department. Periodic adjustments are subsequently made to the extent that the estimates are found to differ from the amounts of contributions actually payable on the basis of reported earnings.

TABLE 1.—CONTRIBUTION RATES AND MAXIMUM TAXABLE AMOUNT OF ANNUAL EARNINGS

Calendar years	Maximum taxable amount of annual earnings	Contribution rates (percent of taxable earnings)					
		Employees and employers, each			Self-employed		
		OASDI	OASI	DI	OASDI	OASI	DI
Past experience:							
1937-49	\$3,000	1.000	1.000				
1950	3,000	1.500	1.500				
1951-53	3,600	1.500	1.500		2.2500	2.2500	
1954	3,600	2.000	2.000		3.0000	3.0000	
1955-56	4,200	2.000	2.000		3.0000	3.0000	
1957-58	4,200	2.250	2.000	0.250	3.3750	3.0000	0.3750
1959	4,800	2.500	2.250	.250	3.7500	3.3750	.3750
1960-61	4,800	3.000	2.750	.250	4.5000	4.1250	.3750
1962	4,800	3.125	2.875	.250	4.7000	4.3250	.3750
1963-65	4,800	3.625	3.375	.250	5.4000	5.0250	.3750
1966	6,600	3.850	3.500	.350	5.8000	5.2750	.5250
1967	6,600	3.900	3.550	.350	5.9000	5.3750	.5250
1968	7,800	3.800	3.325	.475	5.8000	5.0875	.7125
1969	7,800	4.200	3.725	.475	6.3000	5.5875	.7125
1970	7,800	4.200	3.650	.550	6.3000	5.4750	.8250
1971	7,800	4.600	4.050	.550	6.9000	6.0750	.8250
1972	9,000	4.600	4.050	.550	6.9000	6.0750	.8250
1973	10,800	4.850	4.300	.550	7.0000	6.2050	.7950
1974	13,200	4.950	4.375	.575	7.0000	6.1850	.8150
1975	14,100	4.950	4.375	.575	7.0000	6.1850	.8150
Changes scheduled in present law:							
1976-77	(1)	4.950	4.375	.575	7.0000	6.1850	.8150
1978-80	(1)	4.950	4.350	.600	7.0000	6.1500	.8500
1981-85	(1)	4.950	4.300	.650	7.0000	6.0800	.9200
1986-2010	(1)	4.950	4.250	.700	7.0000	6.0100	.9900
2011 plus	(1)	5.950	5.100	.850	7.0000	6.0000	1.0000

¹ Subject to automatic increase.

An employee who worked for more than one employer during the course of a year and paid contributions on wages in excess of the statutory maximum can receive a refund of the contributions he paid on such excess wages. The amount of contributions subject to refund for any period is a charge against each of the trust funds in the ratio in which the amount was appropriated to or deposited in such trust funds for that period.

Another source from which receipts of the trust funds are derived is interest received on investments held by the funds. The investment procedures of the funds are described later in this section.

The income and expenditures of the trust funds are also affected by the provisions of the Railroad Retirement Act which provide for a system of coordination and financial interchange between the railroad retirement program and the old-age, survivors, and disability insurance program.

Sections 217(g) and 229(b) of the Social Security Act authorize annual reimbursements from the general fund of the Treasury to the old-age and survivors insurance and disability insurance trust funds for any costs arising from the granting of noncontributory wage credits for military service, according to periodic determinations made by the Secretary of Health, Education, and Welfare.

Section 228 of the Social Security Act provides monthly cash benefits to certain persons aged 72 and over, almost all of whom are not eligible for cash benefits under other provisions of the old-age, survivors, and disability insurance program. Under section 228, all payments are made initially from the old-age and survivors insurance trust fund, with later reimbursement, with interest, from the general fund of the Treasury for the costs, including administrative expenses, of payments to persons who have less than 3 quarters of coverage. The

reimbursements so made are on a provisional basis and are subject to adjustment, with appropriate interest allowances, as the actual experience develops and is analyzed.

Section 231 of the Social Security Act authorizes reimbursement from the general fund of the Treasury to the old-age and survivors insurance and disability insurance trust funds for any costs arising from the granting of noncontributory wage credits to individuals who were interned during World War II at a place within the United States operated by the Federal government for the internment of persons of Japanese ancestry.

Section 201(i) of the Social Security Act authorizes the Managing Trustee to accept and deposit in the trust funds unconditional money gifts or bequests made for the benefit of the trust funds or any activity financed through such funds.

Expenditures for benefit payments and administrative expenses under the old-age, survivors, and disability insurance program are paid out of the trust funds. All expenses incurred by the Department of Health, Education, and Welfare and by the Treasury Department in carrying out the provisions of Title II of the Social Security Act and of the Internal Revenue Code relating to the collection of contributions are charged to the trust funds. The Secretary of Health, Education, and Welfare certifies benefit payments to the Managing Trustee, who makes the payment from the respective trust funds in accordance therewith.

Section 222(d) of the Social Security Act provides for payments from the trust funds for the cost of vocational rehabilitation services furnished to disabled persons receiving benefits because of their disability. The total amount of funds that may be made available in a fiscal year for payments for the costs of such services, including applicable administrative expenses of State agencies, may not exceed a specified percentage of the benefits certified for payment to these types of beneficiaries in the preceding year. This limitation on the amount to be made available was 1 percent in each of the fiscal years 1966 (when such amounts were first made available) through 1972 and $1\frac{1}{4}$ percent in fiscal year 1973. Under present law, the limitation is $1\frac{1}{2}$ percent in fiscal years after 1973.

Congress has authorized expenditures from the trust funds for construction, rental, and lease or purchase contract of office buildings and related facilities for the Social Security Administration. Both the capital costs of construction financed directly from the trust funds and the rental, lease, or purchase contract costs of acquiring facilities are included in trust fund expenditures. In 1974, construction of several large facilities was begun under purchase contract authority, wherein initial capital costs are borne by the private sector. Under this method of facilities acquisition, trust fund expenditures for use and ultimate Government ownership of a facility are made over periods of from 10 to 30 years. Whatever the manner of acquisition, the net worth of facilities and other fixed capital assets is not carried in the statement of the operations of the trust funds presented in this report. This is because the value of fixed capital assets does not represent funds available for benefit or administrative expenditures, and therefore is not viewed as being a consideration in assessing the actuarial status of the funds.

That portion of each trust fund which, in the judgment of the Managing Trustee, is not required to meet current expenditures for benefits and administration is invested, on a daily basis, in interest-bearing obligations of the U.S. Government (including special public-debt obligations described below), in obligations guaranteed as to both principal and interest by the United States, or in certain federally-sponsored agency obligations that are designated in the laws authorizing their issuance as lawful investments for fiduciary and trust funds under the control and authority of the United States or any officer of the United States. These obligations may be acquired on original issue at the issue price or by purchase of outstanding obligations at their market price.

The Social Security Act authorizes the issuance of special public-debt obligations for purchase exclusively by the trust funds that shall bear interest at a rate based on the average market yield (computed by the Managing Trustee on the basis of market quotations as of the end of the calendar month next preceding the date of such issue) on all marketable interest-bearing obligations of the United States then forming a part of the public-debt which are not due or callable until after the expiration of four years from the end of such calendar month.

SUMMARY OF THE OPERATIONS OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE TRUST FUND, FISCAL YEAR 1974

A statement of the income and disbursements of the Federal old-age and survivors insurance trust fund in the fiscal year which began on July 1, 1973, and ended on June 30, 1974, and of the assets of the fund at the beginning and end of the fiscal year, is presented in table 2. Comparable amounts for fiscal year 1973 are also shown in the table.

The total assets of the old-age and survivors insurance trust fund amounted to \$36,416 million on June 30, 1973. During fiscal year 1974, total receipts amounted to \$50,936 million and total disbursements were \$49,485 million. The assets of the trust fund amounted to \$37,867 million at the end of fiscal year 1974, or \$1,451 million more than at the beginning of the year.

Included in total receipts during fiscal year 1974 were \$43,858 million representing contributions appropriated to the fund, and \$4,989 million representing amounts received by the Secretary of the Treasury in accordance with State agreements for coverage of State and local government employees and deposited in the trust fund. As an offset, \$393 million was transferred from the trust fund into the Treasury as repayment for the estimated amount of contributions subject to refund to employees who worked for more than one employer during the course of a year and paid contributions on wages in excess of the statutory maximum earnings base.

TABLE 2.—STATEMENT OF OPERATIONS OF THE OLD-AGE AND SURVIVORS INSURANCE TRUST FUND DURING FISCAL YEARS 1973 AND 1974

[In thousands]

	Fiscal year	
	1973	1974
Total assets of the trust fund, beginning of year.....	\$36,399,058	\$36,415,896
Receipts:		
Contributions:		
Appropriations.....	37,560,472	43,857,792
Deposits arising from State agreements.....	4,130,891	4,989,458
Gross contributions.....	41,691,363	48,847,250
Less payment into the Treasury for contributions subject to refund.....	373,186	392,557
Net contributions.....	41,318,177	48,454,693
Reimbursement from general fund of the Treasury for costs of:		
Noncontributory credits for military service.....	138,000	139,000
Payments to noninsured persons aged 72 and over:		
Benefit payments.....	292,965	265,890
Administrative expenses.....	3,624	3,173
Interest.....	40,057	33,724
Total reimbursement for payments to noninsured persons aged 72 and over.....	336,645	302,788
Interest:		
Interest on investments.....	1,848,393	2,039,660
Interest on amounts transferred between the old-age and survivors insurance and the disability insurance trust funds due to adjustment in allocation of the costs of vocational rehabilitation services ¹	16	-20
Interest received from general fund of the Treasury on funds advanced in fiscal year 1973 from the old-age and survivors insurance trust fund to finance administrative expenses of the supplemental security income program.....		656
Gross interest.....	1,848,409	2,040,297
Less interest on amounts of interfund transfers due to adjustment in allocation of administrative expenses and construction costs.....	1,891	1,054
Net interest.....	1,846,518	2,039,243
Total receipts ²	43,639,340	50,935,724
Disbursements:		
Benefit payments.....	42,169,744	47,848,838
Transfer to railroad retirement account.....	782,954	908,585
Payment for cost of vocational rehabilitation services for disabled beneficiaries:		
For the current fiscal year.....	2,510	3,534
Transfer from the old-age and survivors insurance and the disability insurance trust funds due to adjustment in allocation of cost for prior fiscal year ³	-40	340
Net payment for cost of vocational rehabilitation services.....	2,470	3,873
Administrative expenses:		
Department of Health, Education, and Welfare.....	611,374	618,506
Treasury Department.....	78,020	87,571
Construction of facilities for Social Security Administration.....	7,446	4,954
Expenses of the Department of Health, Education, and Welfare for administration of vocational rehabilitation program for disabled beneficiaries.....	36	40
Interfund transfers due to adjustment in allocation of:		
Administrative expenses ³	10,874	12,645
Costs of construction ³	609	-353
Gross administrative expenses.....	708,359	723,362
Less receipts from sale of supplies, materials, etc.....	24	47
Less reimbursement from general fund of the Treasury for funds advanced in fiscal year 1973 from the old-age and survivors insurance trust fund to finance administrative expenses of the supplemental security income program.....	41,000	
Net administrative expenses.....	667,335	723,315
Total disbursements.....	43,622,503	49,484,611
Net addition to the trust fund.....	16,837	1,451,113
Total assets of the trust fund, end of year.....	36,415,896	37,867,008

¹ A positive figure represents a transfer of interest to the old-age and survivors insurance trust fund from the other social security trust funds. A negative figure represents a transfer of interest from the old-age and survivors insurance trust fund to the other social security trust funds.

² Includes gifts totaling \$174.78.

³ A positive figure represents a transfer from the old-age and survivors insurance trust fund to the other social security trust funds. A negative figure represents a transfer to the old-age and survivors insurance trust fund from the other social security trust funds.

Net contributions amounted to \$48,455 million, an increase of 17.3 percent over the amount for the preceding fiscal year. Growth in contribution income resulted primarily from (1) the higher level of employment and taxable earnings, (2) the two increases in the maximum annual amount of earnings taxable—from \$9,000 to \$10,800 and from \$10,800 to \$13,200—that became effective on January 1, 1973, and January 1, 1974, respectively, and (3) the two increases in the combined employer-employee contribution rate allocated to finance the old-age and survivors insurance program—from 8.1 percent to 8.6 percent and from 8.6 percent to 8.75 percent—that became effective on January 1, 1973, and January 1, 1974, respectively. Although the first increase in the maximum annual amount of earnings taxable, from \$9,000 to \$10,800, became effective in 1973, the first full fiscal year during which earnings between \$9,000 and \$10,800 were taxable was 1974. Similarly, although the first increase in the combined employer-employee contribution rate allocated to finance the old-age and survivors insurance program, from 8.1 percent to 8.6 percent, became effective in 1973, the first full fiscal year during which the higher rate was operative was 1974.

Reference has been made in an earlier section to provisions of the Social Security Act under which the old-age and survivors insurance and disability insurance trust funds are to be reimbursed annually from the general fund of the Treasury for costs of granting non-contributory credits for military service. In accordance with Section 217(g), the Secretary of Health, Education, and Welfare made a determination in 1970 of the level annual appropriations to the trust funds necessary to amortize over a 44-year period, beginning in fiscal year 1972, the estimated total additional costs, for military service performed before 1957, arising from payments that have been made after August 1950 and that will be made in future years, taking into account the amounts of annual appropriations in fiscal years 1966–71 that have been deposited into the trust funds. The annual amounts resulting from this determination were \$136 million for the old-age and survivors insurance trust fund and \$49 million for the disability insurance trust fund. In accordance with Section 229(b), the Secretary determined that each of the two trust funds should receive reimbursement of \$3 million for additional costs attributable to noncontributory credit for military service performed after 1967. Thus, reimbursements amounting to \$139 million for the old-age and survivors insurance trust fund, and to \$52 million for the disability insurance trust fund, were received in December 1973.

Reference has also been made in an earlier section to provisions under which the old-age and survivors insurance trust fund is to be reimbursed annually from the general fund of the Treasury for costs of monthly payments to certain noninsured persons aged 72 and over who have less than three quarters of coverage. The reimbursement in fiscal year 1974 amounted to \$303 million.

Again, reference has been made in an earlier section to provisions under which money gifts or bequests may be deposited in the old-age and survivors insurance and disability insurance trust funds. In fiscal year 1974, the old-age and survivors insurance trust fund received gifts amounting to \$174.78.

The remaining \$2,039 million of receipts consisted of interest on the investments of the trust fund and net interest on amounts of interfund transfers arising out of adjustments in the allocation of administrative expenses, construction costs, and the cost of vocational rehabilitation services for the prior fiscal year, 1973.

Of the \$49,485 million in total disbursements, \$47,849 million was for benefit payments, an increase of 13.5 percent over the corresponding amount paid in fiscal year 1973. This increase was due to (1) the amendments enacted on July 1, 1972, which provided for a general increase in benefits of 20 percent effective for September 1972, (2) the amendments enacted on October 30, 1972, which provided higher benefit amounts for certain categories of beneficiaries and liberalized some of the conditions under which persons can qualify for benefits, (3) the amendments enacted on December 31, 1973, which provided for a general increase in benefits of 11 percent effective in two steps—an interim increase of 7 percent effective for the 3 months March–May 1974, followed by the full 11-percent increase effective for June 1974, and (4) the expected growth in the total number of beneficiaries and in average benefit amounts resulting from the rising level of earnings. Although the amendments enacted in 1972 became effective during fiscal year 1973, the first full fiscal year during which they were operative was 1974.

Reference has been made in an earlier section to provisions of the Railroad Retirement Act which coordinate the railroad retirement and the old-age and survivors insurance programs and which govern the financial interchanges arising from the allocation of costs between the two systems. In accordance with these provisions, the Railroad Retirement Board and the Secretary of Health, Education, and Welfare determined that a transfer of \$866,800,000 to the railroad retirement account from the old-age and survivors insurance trust fund would place this trust fund in the same position as of June 30, 1973, as it would have been if railroad employment had always been covered under the Social Security Act. This amount was transferred to the railroad retirement account in May 1974, together with interest to the date of transfer amounting to \$41,785,000.

Expenditures of the old-age and survivors insurance program for the cost of vocational rehabilitation services amounted to nearly \$3.9 million. These services were furnished to disabled adults—dependents of old-age beneficiaries and survivors of deceased insured workers—who were receiving monthly benefits from the old-age and survivors insurance trust fund because of their disability.

The remaining \$723 million of disbursements from the old-age and survivors insurance trust fund represents net administrative expenses. The expenses of administering the programs financed through the four trust funds—the old-age and survivors insurance, disability insurance, hospital insurance, and supplementary medical insurance trust funds—are allocated and charged directly to each trust fund on the basis of provisional estimates. Beginning in fiscal year 1974, the expenses of administering the newly enacted Supplemental Security Income program are also allocated, on a provisional basis, and charged directly to the general fund of the Treasury. Periodically, as actual experience

develops and is analyzed, adjustments to the allocations of administrative expenses and costs of construction for price periods are effected by interfund transfers, with appropriate interest allowances. (In fiscal year 1973, the administrative expenses of the new Supplemental Security Income program were initially charged to the old-age and survivors insurance trust fund because no money had yet been appropriated from the general fund of the Treasury. Reimbursement representing only the principal of \$41 million, but excluding interest, was received from the general fund at the end of fiscal year 1973. Interest on this amount was received from the general fund in fiscal year 1974.)

Net administrative expenses charged to the old-age and survivors insurance trust fund and to the disability insurance trust fund in fiscal year 1974 totaled \$878 million. This amount represented 1.6 percent of contribution income and 1.6 percent of expenditures for benefit payments and payments for the cost of vocational rehabilitation services during the fiscal year. Corresponding percentages for each of the last 5 years for the system as a whole and for each trust fund separately are shown in table 3.

In table 4, the experience with respect to actual amounts of contributions and benefit payments in fiscal year 1974 is compared with the estimates for fiscal year 1974 which appeared in the 1974 Annual Report of the Board of Trustees. Reference was made in an earlier section to the appropriation of contributions to the trust funds on an estimated basis, with subsequent periodic adjustments to account for differences from the amounts of contributions actually payable on the basis of reported earnings. In interpreting the figures in table 4, it should be noted that the "actual" amount of contributions in fiscal year 1974 reflects the aforementioned type of adjustments to contributions for prior fiscal years. On the other hand, the "actual" amount of contributions in fiscal year 1974 does not reflect adjustments to contributions for fiscal year 1974 that were to be made after June 30, 1974. The actual experience for each trust fund was quite close, relatively, to the estimates.

At the end of fiscal year 1974, about 30.2 million persons were receiving monthly benefits under the old-age, survivors, and disability insurance program. About 26.5 million of these persons were receiving monthly benefits from the old-age and survivors insurance trust fund. The distribution of benefit payments in fiscal years 1973 and 1974, by type of beneficiary, is shown in table 5. Approximately 72 percent of the total benefit payments from the old-age and survivors insurance trust fund in fiscal year 1974 was accounted for by monthly benefits to retired workers and their dependents and about 17 percent by monthly benefits to aged survivors and disabled widows or widowers of deceased workers. Approximately 10 percent of the benefit payments represented monthly benefits on behalf of children of deceased workers and monthly benefits to mothers who had children of deceased workers in their care.

TABLE 3.—RELATIONSHIP OF NET ADMINISTRATIVE EXPENSES OF THE OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROGRAM TO CONTRIBUTION INCOME AND BENEFIT PAYMENTS, BY TRUST FUND, FISCAL YEARS 1970-74

Fiscal year	Total administrative expenses as a percentage of—		Old-age and survivors insurance trust fund, administrative expenses as a percentage of—		Disability insurance trust fund, administrative expenses as a percentage of—	
	Total contribution income	Total benefit payments ¹	Contribution income	Benefit payments ¹	Contribution income	Benefit payments ¹
1970.....	1.8	2.1	1.6	1.8	3.0	5.3
1971.....	2.0	2.1	1.7	1.8	4.2	5.6
1972.....	2.0	2.1	1.6	1.7	4.4	5.2
1973.....	2.0	1.9	1.6	1.6	4.5	4.7
1974.....	1.6	1.6	1.5	1.5	2.5	2.5

¹ In determining the percentage shown, payments for the cost of vocational rehabilitation services are included with benefit payments.

Note: In interpreting the figures in the above table, reference should be made to the accompanying text.

TABLE 4.—COMPARISON OF ACTUAL AND ESTIMATED OPERATIONS OF THE OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS, FISCAL YEAR 1974

[In millions]

	Actual amount	Estimated amount published in 1974 report	Actual as percentage of estimate
Old-age and survivors insurance trust fund:			
Net contributions.....	\$48,455	\$48,484	100
Benefit payments.....	47,849	48,118	99
Disability insurance trust fund:			
Net contributions.....	6,234	6,243	100
Benefit payments.....	6,159	6,180	100

Note: In interpreting the figures in the above table, reference should be made to the accompanying text.

TABLE 5.—ESTIMATED DISTRIBUTION OF BENEFIT PAYMENTS FROM THE OLD-AGE AND SURVIVORS INSURANCE TRUST FUND, BY TYPE OF BENEFICIARY AND PAYMENT, FISCAL YEARS 1973 AND 1974

[In millions]

	1973		1974	
	Amount	Percent of total	Amount	Percent of total
Total.....	\$42,169.7	100	\$47,848.8	100
Monthly benefits.....	41,848.6	99	47,533.0	99
Retired workers and their dependents.....	30,511.4	72	34,390.5	72
Retired workers.....	27,261.6	65	30,793.1	64
Wives and husbands.....	2,821.8	7	3,112.9	7
Children.....	428.0	1	484.6	1
Survivors of deceased workers.....	11,066.5	26	12,891.8	27
Aged widows and widowers.....	6,359.0	15	7,764.4	16
Disabled widows and widowers.....	105.9	(1)	129.3	(1)
Parents.....	46.4	(1)	47.7	(1)
Children.....	3,807.6	9	4,167.6	9
Widowed mothers caring for child beneficiaries.....	747.6	2	842.9	2
Noninsured persons aged 72 and over ²	270.8	1	250.7	1
Lump-sum death benefits.....	321.1	1	315.9	1

¹ Less than 0.5 percent.

² The trust fund is reimbursed from the general fund of the Treasury for the costs of payments to beneficiaries with less than 3 quarters of coverage.

TABLE 6.—ASSETS OF THE OLD-AGE AND SURVIVORS INSURANCE TRUST FUND, BY TYPE, AT THE END OF FISCAL YEARS 1973 AND 1974

	June 30, 1973		June 30, 1974	
	Par value	Book value ¹	Par value	Book value ¹
Investments in public-debt obligations:				
Public issues:				
Treasury notes:				
6 percent, 1975.....	\$17,450,000	\$17,450,000.00	\$17,450,000	\$17,450,000.00
6½ percent, 1976.....	5,000,000	4,995,386.97	5,000,000	4,997,172.69
6½ percent, 1976.....	22,180,000	22,180,000.00	22,180,000	22,180,000.00
7 percent, 1975.....	50,000,000	49,943,137.16	50,000,000	49,966,666.52
7½ percent, 1976.....	90,500,000	90,260,384.50	90,500,000	90,338,097.70
8 percent, 1977.....	15,000,000	15,000,000.00	15,000,000	15,000,000.00
Treasury bonds:				
2½ percent, investment series B, 1975-80.....	1,064,902,000	1,064,902,000.00	1,064,902,000	1,064,902,000.00
3 percent, 1995.....	70,170,000	70,147,900.36	70,170,000	70,148,924.32
3¼ percent, 1978-83.....	60,200,000	59,613,079.52	60,200,000	59,672,264.72
3¼ percent, 1985.....	25,700,000	24,671,244.59	25,700,000	24,758,181.71
3½ percent, 1980.....	449,450,000	452,648,813.67	449,450,000	452,212,611.87
3½ percent, 1990.....	556,250,000	549,213,292.86	556,250,000	549,637,617.06
3½ percent, 1998.....	552,037,000	544,216,472.68	552,037,000	544,525,177.84
4 percent, 1973.....	38,000,000	37,996,987.90		
4 percent, 1980.....	153,100,000	153,067,982.44	153,100,000	153,072,846.04
4½ percent, 1974.....	61,934,000	61,930,461.83		
4½ percent, 1989-94.....	91,300,000	90,670,287.42	91,300,000	90,700,513.62
4½ percent, 1974.....	6,352,000	6,353,470.08		
4½ percent, 1975-85.....	78,023,000	77,774,698.43	78,023,000	77,795,681.75
4½ percent, 1987-92.....	33,000,000	34,499,072.43	33,000,000	34,392,629.43
6½ percent, 1984.....	31,500,000	32,007,081.30	31,500,000	31,961,671.02
7 percent, 1981.....	50,000,000	49,673,333.26	50,000,000	49,713,333.22
7½ percent, 1988-93.....			99,934,000	98,411,627.93
8½ percent, 1994-99.....			6,352,000	6,531,829.12
Total investments in public issues.....	3,522,048,000	3,509,215,087.40	3,522,048,000	3,508,368,846.56
Obligations sold only to this fund (special issues):				
Notes:				
4½ percent, 1974.....	2,720,279,000	2,720,279,000.00		
5½ percent, 1975.....	2,460,795,000	2,460,795,000.00	2,460,795,000	2,460,795,000.00
5½ percent, 1979.....	3,102,896,000	3,102,896,000.00	3,102,896,000	3,102,896,000.00
6½ percent, 1978.....	3,468,850,000	3,468,850,000.00	3,468,850,000	3,468,850,000.00
6½ percent, 1976.....	3,844,864,000	3,844,864,000.00	3,844,864,000	3,844,864,000.00
6½ percent, 1980.....	4,547,285,000	4,547,285,000.00	4,547,285,000	4,547,285,000.00
7½ percent, 1977.....	5,033,296,000	5,033,296,000.00	5,033,296,000	5,033,296,000.00
Bonds:				
2½ percent, 1975.....	685,178,000	685,178,000.00		
3½ percent, 1975.....	160,077,000	160,077,000.00		
3½ percent, 1976.....	1,080,011,000	1,080,011,000.00	760,998,000	760,998,000.00
3½ percent, 1977.....	1,080,011,000	1,080,011,000.00	1,080,011,000	1,080,011,000.00
3½ percent, 1978.....	658,444,000	658,444,000.00	658,444,000	658,444,000.00
4½ percent, 1978.....	421,567,000	421,567,000.00	421,567,000	421,567,000.00
4½ percent, 1979.....	1,080,011,000	1,080,011,000.00	1,080,011,000	1,080,011,000.00
4½ percent, 1980.....	1,080,011,000	1,080,011,000.00	1,080,011,000	1,080,011,000.00
7½ percent, 1981.....			677,910,000	677,910,000.00
7½ percent, 1982.....			677,910,000	677,910,000.00
7½ percent, 1983.....			677,910,000	677,910,000.00
7½ percent, 1984.....			677,910,000	677,910,000.00
7½ percent, 1985.....			677,910,000	677,910,000.00
7½ percent, 1986.....			677,910,000	677,910,000.00
7½ percent, 1987.....			677,910,000	677,910,000.00
7½ percent, 1988.....			677,909,000	677,909,000.00
7½ percent, 1989.....			677,909,000	677,909,000.00
Total obligations sold only to this fund (special issues).....	31,423,575,000	31,423,575,000.00	33,640,216,000	33,640,216,000.00
Total investments in public-debt obligations.....	34,945,623,000	34,932,790,087.40	37,162,264,000	37,148,584,846.56

See footnote at end of table p. 13.

TABLE 6.—ASSETS OF THE OLD-AGE AND SURVIVORS INSURANCE TRUST FUND, BY TYPE, AT THE END OF FISCAL YEARS 1973 AND 1974—Continued

	June 30, 1973		June 30, 1974	
	Par value	Book value ¹	Par value	Book value ¹
Investments in federally-sponsored agency obligations:				
Participation certificates:				
Federal Assets Liquidation Trust-Government National Mortgage Association:				
5.10 percent, 1987.....	50,000,000	50,000,000.00	50,000,000	50,000,000.00
5.20 percent, 1982.....	100,000,000	100,000,000.00	100,000,000	100,000,000.00
Federal Assets Financing Trust-Government National Mortgage Association:				
6.05 percent, 1988.....	65,000,000	64,822,265.95	65,000,000	64,834,453.51
6.20 percent, 1988.....	230,000,000	230,000,000.00	230,000,000	230,000,000.00
6.40 percent, 1987.....	75,000,000	75,000,000.00	75,000,000	75,000,000.00
6.45 percent, 1988.....	35,000,000	35,000,000.00	35,000,000	35,000,000.00
Total investments in federally-sponsored agency obligations....	555,000,000	554,822,265.95	555,000,000	554,834,453.51
Total investments.....	35,500,623,000	35,487,612,353.35	37,717,264,000	37,703,419,300.07
Undisbursed balances.....		928,283,163.88		163,589,142.13
Total assets.....		36,415,895,517.23		37,867,008,442.20

¹ Par value, plus unamortized premium, less discount outstanding.

Benefit payments to noninsured persons aged 72 and over amounted to \$251 million, or slightly more than ½ percent of total benefit payments from the trust fund. Reference has been made in an earlier section to the legislative provisions governing reimbursement from the general fund of the Treasury for the costs of such payments to persons who have fewer than three quarters of coverage. About 98 percent of the total amount of the payments made in fiscal year 1974 to noninsured persons aged 72 and over went to persons with fewer than three quarters of coverage.

The balance of the benefits paid during fiscal year 1974 consisted of lump-sum death payments.

The assets of the old-age and survivors insurance trust fund at the end of fiscal year 1974 totaled \$37,867 million, consisting of \$37,703 million in the form of obligations of the U.S. Government or of federally-sponsored agency obligations, and an undisbursed balance of \$164 million. Table 6 shows a comparison of the total assets of the fund and their distribution at the end of fiscal years 1973 and 1974.

The net increase in the par value of the investments owned by the fund during fiscal year 1974 amounted to \$2,217 million. New securities at a total par value of \$58,824 million were acquired during the fiscal year through the investment of receipts, and the reinvestment of funds made available from the redemption of securities. The par value of securities redeemed during the fiscal year was \$56,607 million. Included in these amounts is \$52,723 million in certificates of indebtedness that were acquired and redeemed within the fiscal year. In addition, \$38 million in 4-percent bonds maturing in August 1973 and \$62 million in 4½-percent bonds maturing in February 1974 were exchanged for \$100 million in 7½-percent bonds maturing in August of 1993, and \$6 million in 4¼-percent bonds maturing in May 1974 were exchanged for an equal amount of 8½-percent bonds maturing in May of 1999. Although the interest rate on bonds is generally limited to 4¼ percent by the provisions of 31 U.S.C. 752, amendments to these provisions

authorize the issuance of bonds at rates of interest exceeding $4\frac{1}{4}$ percent, subject to certain restrictions. P.L. 92-5, enacted March 17, 1971, amended the provisions to authorize the issuance to the public and to Government accounts of up to a total of \$10 billion in bonds at rates of interest exceeding $4\frac{1}{4}$ percent. P.L. 93-53, enacted July 1, 1973, further amended the provisions of 31 U.S.C. 752 by (1) removing the \$10 billion limitation on the aggregate face amount of such bonds that may be issued and (2) limiting the amount of such bonds that may be held by the public at any one time to \$10 billion.

The effective annual rate of interest earned by the assets of the old-age and survivors insurance trust fund during fiscal year 1974 was 5.9 percent. The interest rate on special issues purchased by the trust fund in June 1974 was $7\frac{5}{8}$ percent, payable semiannually.

The 1956 amendments provided that the public-debt obligations issued for purchase by the old-age and survivors insurance trust fund and the disability insurance trust fund shall have maturities fixed with due regard for the needs of the funds. Under these amendments, the general practice in the past was to spread the maturity dates for the holdings of special issues as nearly as practicable in equal amounts over a 15-year period. As a result of this practice, the old-age and survivors insurance trust fund held (1) special issues, totaling \$5,081 million, that were acquired before 1966 and were distributed in equal amounts of about \$1,080 million maturing in each of the years 1977-80 and in a smaller amount maturing in 1976 (table 6).

However, the interest rate on special issues acquired in June of each year 1966-74, as determined under section 201(d) of the Social Security Act, was higher than the maximum rate of $4\frac{1}{4}$ percent to which the interest rate on long-term issues (bonds) is generally limited. Thus, the former practice could not be followed until the enactment of P.L. 93-53 on July 1, 1973. Accordingly, the entire amounts available for investment in June of each year 1966-73 were invested in short-term issues (notes). As a result, the old-age and survivors insurance trust fund held \$22,458 million in special issues consisting of 7-year notes that were distributed in varying amounts maturing on June 30 of each year 1975-80 (table 6).

On June 30, 1974, the investment practice in effect before 1966 was reinstated, and the old-age and survivors insurance trust fund acquired \$6,101 million in special issues that were distributed in virtually equal amounts of about \$678 million maturing in each of the years 1981-1989 (table 6). The investment operations of the fund in fiscal years 1973 and earlier are described in the 1974, and earlier, annual reports.

SUMMARY OF THE OPERATIONS OF THE FEDERAL DISABILITY INSURANCE TRUST FUND, FISCAL YEAR 1974

A statement of the income and disbursements of the Federal disability insurance trust fund during fiscal year 1974, and of the assets of the fund at the beginning and end of the fiscal year is presented in table 7. Comparable amounts for fiscal year 1973 are also shown in the table.

The total assets of the disability insurance trust fund amounted to \$7,869 million on June 30, 1973. During fiscal year 1974, total receipts amounted to \$6,768 million and total disbursements were \$6,385 million. The assets of the trust fund thus increased \$383 million during the year to a total of \$8,253 million on June 30, 1974.

Included in total receipts were \$5,652 million representing contributions appropriated to the fund, and \$633 million representing amounts received by the Secretary of the Treasury in accordance with State coverage agreements and deposited in the fund. As an offset, \$50 million was transferred from the trust fund into the Treasury as repayment for the estimated amount of contributions subject to refund to employees who worked for more than one employer during the course of a year and paid contributions on wages in excess of the statutory maximum earnings base.

TABLE 7.—STATEMENT OF OPERATIONS OF THE DISABILITY INSURANCE TRUST FUND DURING FISCAL YEARS
1973 AND 1974
[In thousands]

	Fiscal year	
	1973	1974
Total assets of the trust fund, beginning of year	\$7,390,277	\$7,869,472
Receipts:		
Contributions:		
Appropriations	4,961,148	5,651,996
Deposits arising from State agreements	550,447	632,646
Gross contributions	5,511,595	6,284,642
Less payment into the Treasury for contributions subject to refund	50,626	50,217
Net contributions	5,460,969	6,234,425
Reimbursement from general fund of the Treasury for costs of noncontributory credits for military service	51,000	52,000
Interest:		
Interest on investments	434,840	479,140
Interest on amounts of interfund transfers due to adjustment in allocation of administrative expenses and construction costs ¹	—244	2,641
Interest on amounts transferred between the old-age and survivors insurance and the disability insurance trust funds due to adjustment in allocation of cost of vocational rehabilitation services ¹	—16	20
Net interest	434,580	481,800
Total receipts	5,946,549	6,768,225
Disbursements:		
Benefit payments	5,161,840	6,158,569
Transfer to railroad retirement account	19,503	22,327
Payment for cost of vocational rehabilitation services for disabled beneficiaries:		
For the current fiscal year	39,321	49,331
Transfer to the old-age and survivors insurance trust fund due to adjustment in allocation of cost for prior fiscal year	40	340
Total cost of vocational rehabilitation services	39,361	49,670
Administrative expenses:		
Department of Health, Education, and Welfare	223,049	185,814
Treasury Department	9,849	11,650
Construction of facilities for Social Security Administration	2,104	329
Expenses of the Department of Health, Education, and Welfare for administration of vocational rehabilitation program for disabled beneficiaries	564	560
Interfund transfers due to adjustment in allocation of—		
Administrative expenses ²	11,302	—44,353
Costs of construction ²	—214	280
Gross administrative expenses	246,653	154,281
Less receipts from sales of surplus supplies, materials, etc.	4	14
Net administrative expenses	246,649	154,266
Total disbursements	5,467,354	6,384,833
Net addition to the trust fund	479,195	383,392
Total assets of the trust fund, end of year	7,869,472	8,252,865

¹ A positive figure represents a transfer of interest to the disability insurance trust fund from the other social security trust funds. A negative figure represents a transfer of interest from the disability trust fund to the other social security trust funds.

² A positive figure represents a transfer from the disability insurance trust fund to the other social security trust funds. A negative figure represents a transfer to the disability insurance trust fund from the other social security trust funds.

Net contributions amounted to \$6,234 million, an increase of 14.2 percent over the amount for the preceding fiscal year. This increase is accounted for, in part, by the same factors, insofar as they apply to contributions of the disability insurance trust fund, that accounted for the increase in contributions to the old-age and survivors insurance trust fund (described in the preceding section), and in part by the provision in P.L. 93-233, enacted December 31, 1973, that increased the portion of the contribution rate allocated to finance benefits from the disability insurance trust fund. Effective January 1, 1974, the allocated rate for employees and employers was increased from 0.55 percent of taxable earnings each to 0.575 percent each. For the self-employed, the allocated rate was increased from 0.795 percent to 0.815 percent.

In addition, the trust fund received \$52 million in December from the general fund of the Treasury, as reimbursement for the costs of noncontributory credits for military service.

The remaining \$482 million of receipts consisted of interest on the investments of the fund, plus interest on amounts of interfund transfers.

Of the \$6,385 million in total disbursements, \$6,159 million was for benefit payments, an increase of 19.3 percent over the corresponding amount paid in the fiscal year 1973. This increase is accounted for by the same factors insofar as they apply to disabled-worker beneficiaries and their dependents, that resulted in the increase in benefit payments from the old-age and survivors insurance trust fund (described in the preceding section).

Provisions governing the financial interchanges between the railroad retirement account and the disability insurance trust fund are similar to those referred to in the preceding section relating to the old-age and survivors insurance trust fund. The determination made as of June 30, 1973, required that a transfer of \$21,300,000 be made from the disability insurance trust fund to the railroad retirement account. This amount was transferred to the railroad retirement account in May 1974 together with interest to the date of transfer amounting to \$1,027,000.

The remaining disbursements amounted to \$154 million for net administrative expenses and \$50 million for the cost of vocational rehabilitation services furnished to disabled-worker beneficiaries and to those dependents of disabled workers who are receiving benefits on the basis of disabilities that have continued since childhood.

As stated in an earlier section, the total amount of funds that may be made available in a fiscal year for payment for the costs of vocational rehabilitation services may not exceed a specified percentage of the benefits certified for payment in the preceding year from the old-age and survivors insurance and disability insurance trust funds to disabled persons receiving benefits because of their disability. This limitation on the amounts to be made available was 1 percent in each fiscal year through 1972, $1\frac{1}{4}$ percent in fiscal year 1973, and $1\frac{1}{2}$ percent in fiscal year 1974. The following data show the relationship between the total amount of payments for the costs of such rehabilitation services for each fiscal year, 1970-74, and the corresponding amount

of benefits paid in the prior fiscal year from the trust funds to disabled beneficiaries:

Fiscal year to which costs of rehabilitation services are charged	Amount of payments for costs of rehabilitation services ¹ (in thousands)	Estimated amount of benefit payments in preceding fiscal year to disabled beneficiaries (in thousands)	Payments for costs of rehabilitation services as percent of preceding year's benefit payments
1970 -----	\$20,610	\$2,155,579	0.96
1971 -----	23,099	2,464,004	.94
1972 -----	29,940	3,028,695	.99
1973 -----	39,889	3,629,590	1.10
1974 -----	55,242	4,647,721	1.19

¹ The amounts shown represent the expenditures for a fiscal year and differ from amounts expended in a fiscal year as shown in accounting statements of the trust funds on a cash basis. The amount shown for each fiscal year is subject to further change.

At the end of fiscal year 1974, some 3,691,000 persons were receiving monthly benefits from the disability insurance trust fund. The distribution of benefit payments in fiscal years 1973 and 1974, by type of beneficiary, is shown in table 8.

TABLE 8.—ESTIMATED DISTRIBUTION OF BENEFIT PAYMENTS FROM THE DISABILITY INSURANCE TRUST FUND, BY TYPE OF BENEFICIARY, FISCAL YEARS 1973 AND 1974

[In millions]

	1973		1974	
	Amount	Percent of total	Amount	Percent of total
Total -----	\$5,161.8	100	\$6,158.6	100
Disabled workers -----	4,201.9	81	5,042.5	82
Wives and husbands -----	255.4	5	296.8	5
Children -----	704.6	14	819.3	13

The assets of this fund at the end of fiscal year 1974 totalled \$8,253 million, consisting of \$8,193 million in the form of obligations of the U.S. Government and an undisbursed balance of \$60 million. Table 9 shows a comparison of the total assets of the fund and their distribution at the end of fiscal years 1973 and 1974.

The net increase in the par value of the investments owned by the fund during the fiscal year amounted to \$391 million. New securities at a total par value of \$7,856 million were acquired during the fiscal year through the investment of receipts, the reinvestment of funds made available from the redemption of securities, and the exchange of securities. The par value of securities redeemed or exchanged during the year was \$7,465 million. Included in these amounts is \$6,734 million in certificates of indebtedness that were acquired and redeemed within the fiscal year.

The effective annual rate of interest earned by the assets of the disability insurance trust fund during fiscal year 1974 was 6.4 percent. The interest rate on public-debt obligations issued for purchase by the trust fund in June 1974 was 7½ percent, payable semiannually.

The investment policy and practices described in the preceding section apply equally to investments of the assets of the disability insurance trust fund. A distribution of these investments by type of government security and date of maturity is shown in table 9.

TABLE 9.—ASSETS OF THE DISABILITY INSURANCE TRUST FUND, BY TYPE, AT THE END OF FISCAL YEARS 1973 AND 1974

	June 30, 1973		June 30, 1974	
	Par value	Book value ¹	Par value	Book value ¹
Investments in public-debt obligations:				
Public issues:				
Treasury notes:				
6 percent, 1975.....	\$3,750,000	\$3,750,000.00	\$3,750,000	\$3,750,000.00
6 percent, 1978.....	2,000,000	2,004,109.32	2,000,000	2,003,350.68
6½ percent, 1978.....	2,000,000	2,004,686.65	2,000,000	2,003,664.13
7½ percent, 1976.....	26,000,000	25,941,341.65	26,000,000	25,960,366.09
7½ percent, 1977.....	14,000,000	13,979,337.38	14,000,000	13,984,397.66
8 percent, 1977.....	10,000,000	10,000,000.00	10,000,000	10,000,000.00
Treasury bonds:				
3½ percent, 1990.....	10,500,000	10,041,180.86	10,500,000	10,068,848.42
3½ percent, 1998.....	5,000,000	4,736,355.80	5,000,000	4,746,762.80
4 percent, 1973.....	16,500,000	16,498,008.72	-----	-----
4 percent, 1980.....	30,250,000	30,244,508.57	30,250,000	30,245,342.45
4½ percent, 1974.....	10,000,000	10,001,605.28	-----	-----
4½ percent, 1989-94.....	68,400,000	67,706,106.00	68,400,000	67,739,412.84
4½ percent, 1975-85.....	20,795,000	20,778,902.14	20,795,000	20,779,645.42
4½ percent, 1987-92.....	80,800,000	80,927,138.07	80,800,000	80,918,110.59
6½ percent, 1984.....	15,000,000	15,060,582.25	15,000,000	15,055,156.93
7½ percent, 1988-93.....	-----	-----	26,500,000	25,764,571.55
Total investments in public issues.....	314,995,000	313,673,862.69	314,995,000	313,019,629.56
Obligations sold only to this fund (special issues):				
Notes:				
4½ percent, 1974.....	309,178,000	309,178,000.00	-----	-----
5½ percent, 1975.....	583,612,000	583,612,000.00	583,612,000	583,612,000.00
5½ percent, 1979.....	1,058,617,000	1,058,617,000.00	1,058,617,000	1,058,617,000.00
6½ percent, 1978.....	1,284,249,000	1,284,249,000.00	1,284,249,000	1,284,249,000.00
6½ percent, 1976.....	1,151,608,000	1,151,608,000.00	1,151,608,000	1,151,608,000.00
6½ percent, 1980.....	943,266,000	943,266,000.00	943,266,000	943,266,000.00
7½ percent, 1977.....	1,394,466,000	1,394,466,000.00	1,394,466,000	1,394,466,000.00
Bonds:				
2½ percent, 1975.....	2,366,000	2,366,000.00	-----	-----
3½ percent, 1975.....	20,738,000	20,738,000.00	-----	-----
3½ percent, 1976.....	153,632,000	153,632,000.00	-----	-----
3½ percent, 1977.....	153,632,000	153,632,000.00	-----	-----
3½ percent, 1978.....	153,632,000	153,632,000.00	89,570,000	89,570,000.00
4½ percent, 1979.....	153,632,000	153,632,000.00	153,632,000	153,632,000.00
4½ percent, 1980.....	125,606,000	125,606,000.00	125,606,000	125,606,000.00
7½ percent, 1981.....	-----	-----	121,663,000	121,663,000.00
7½ percent, 1982.....	-----	-----	121,663,000	121,663,000.00
7½ percent, 1983.....	-----	-----	121,663,000	121,663,000.00
7½ percent, 1984.....	-----	-----	121,663,000	121,663,000.00
7½ percent, 1985.....	-----	-----	121,663,000	121,663,000.00
7½ percent, 1986.....	-----	-----	121,663,000	121,663,000.00
7½ percent, 1987.....	-----	-----	121,663,000	121,663,000.00
7½ percent, 1988.....	-----	-----	121,663,000	121,663,000.00
7½ percent, 1989.....	-----	-----	121,663,000	121,663,000.00
Total obligations sold only to this fund (special issues).....	7,488,234,000	7,488,234,000.00	7,879,593,000	7,879,593,000.00
Total investments in public-debt obligations.....	7,803,229,000	7,801,907,862.69	8,194,588,000	8,192,612,629.56
Undisbursed balances.....	-----	67,564,541.18	-----	60,251,890.80
Total Assets.....	-----	7,869,472,403.87	-----	8,252,864,520.36

¹ Par value, plus unamortized premium, less discount outstanding.

EXPECTED OPERATIONS AND STATUS OF THE TRUST FUNDS DURING THE PERIOD JULY 1, 1974, TO DECEMBER 31, 1979

In the following statement of the expected operations and status of the trust funds during the period July 1, 1974, to December 31, 1979, it is assumed that present statutory provisions affecting the old-age, survivors, and disability insurance program will remain unchanged in the period 1975-79. The income and disbursements of the program, however, are affected by general economic conditions as well as by legislative provisions. Economic conditions, of course, affect the levels of employment and taxable earnings; but beginning in 1975, under the automatic increase provisions in present law, economic conditions will also directly affect benefits, the contribution and benefit base (i.e., the maximum annual amount of earnings taxable and creditable toward benefits), and the annual exempt amount under the retirement test.

Under the automatic provisions, benefits will increase in accordance with increases in the Consumer Price Index (CPI). In 1975,¹ and in each year thereafter which immediately follows a year in which an automatic benefit increase becomes effective, the contribution and benefit base, and the amount of earnings exempted from the withholding of benefits under the retirement test, automatically increase in proportion to the increase in average wages in covered employment. The first such automatic increase in the contribution and benefit base, from \$13,200 in 1974 to \$14,100 in 1975, and in the annual exempt amount under the retirement test, from \$2,400 in 1974 to \$2,520 in 1975 were established October 29, 1974, as described in Appendix B. The first automatic cost-of-living benefit increase, effective for June 1975, has been determined to be 8.0 percent.

Under the economic assumptions on which the estimates in this section, and in the following section, are based,² the assumed future path of the CPI, assumed future increases in average wages in covered employment, and assumed future rates of unemployment for calendar years 1975-80 have the values shown in the following table:

Calendar year	Assumed percentage increase over prior year in annual average wages and in annual average CPI		Assumed annual average unemployment rate (percent)
	Increase in wages	Increase in CPI	
1975.....	6.2	9.0	8.8
1976.....	9.0	6.6	8.0
1977.....	11.0	6.5	7.0
1978.....	8.8	5.7	6.2
1979.....	7.7	4.6	5.4
1980.....	7.0	4.0	4.8

¹ Public Law 93-233 provided that the 11-percent general benefit increase that became effective in 1974 be considered an automatic cost-of-living benefit increase for purposes of the automatic provisions.

² The economic assumptions underlying the estimates in this report differ from the assumptions that appear on page 41 of the President's 1976 Budget. The estimates in this report reflect the significant changes in economic indicators and trends that have taken place since the earlier Budget assumptions were prepared (e.g., a lower level of economic activity and higher rates of unemployment, as well as a somewhat lower rate of increase in the Consumer Price Index).

In accordance with the above assumptions, the estimates reflect the following changes that would occur, under the automatic provisions, in each year 1976-79 (amounts for 1975 are also shown as a basis for comparison) :

Year	General benefit increase (percent) ¹	Contribution and benefit base ²	Annual exempt amount under the retirement test ²
1975.....	8.0	\$14, 100	\$2, 520
1976.....	6.6	15, 000	2, 640
1977.....	6.4	16, 500	2, 880
1978.....	6.3	18, 300	3, 240
1979.....	4.8	19, 800	3, 480

¹ Effective with benefits for June of the stated year.

² Effective on Jan. 1 of the stated year.

Statements of the expected operations of the trust funds should be read with full recognition of the difficulties of estimating future income and disbursements. Both future benefit levels and future amounts of contribution income are highly sensitive to assumed changes in economic activity—e.g., changes in the CPI, levels of employment, and earnings levels. Because it is difficult to forecast accurately future changes in these economic indicators, the resulting estimates of the progress of the trust funds are subject to many uncertainties.

Table 10 presents data on the actual operations of the old-age and survivors insurance trust fund for selected fiscal years during the period 1940-74 ³ and also estimates of the expected operations of the trust fund in fiscal years 1975-79. Because of the current economic recession, the estimated number of persons with taxable earnings under the old-age, survivors, and disability insurance program is expected to decline from about 101 million during calendar year 1974 to about 98 million during calendar year 1975. After 1975, the number of persons with taxable earnings is expected to increase each year, reaching about 110 million during calendar year 1979. Although the number of persons with taxable earnings is expected to decline from 1974 to 1975, the total annual amount of taxable earnings is expected to increase from \$632 billion in 1974 to \$653 billion in 1975, because the percentage increase in estimated average taxable earnings, of about 6 percent, more than offsets the 2½-percent decrease in the estimated number of persons with taxable earnings. The total annual amount of taxable earnings is expected to continue to increase in each year after 1975, rising to \$1,021 billion in 1979. These increases are due in part to the future automatic increases in the contribution and benefit base previously set forth.

³ Data relating to the operations of the two trust funds for years not shown in the tables of this section are contained in earlier annual reports.

TABLE 10.—OPERATIONS OF THE OLD-AGE AND SURVIVORS INSURANCE TRUST FUND DURING SELECTED FISCAL YEARS 1940-74 AND ESTIMATED FUTURE OPERATIONS DURING FISCAL YEARS 1975-79

(In millions)

Fiscal year ¹	Transactions during period										Fund at end of period
	Income			Disbursements							
	Total	Reimbursements from general fund of Treasury for costs of—		Interest on investments ²	Total	Benefit payments	Payments for vocational rehabilitation services	Administrative expenses ²	Transfers to railroad retirement account	Net increase in fund	
		Contributions, less refunds	Non-tributory credits for military service								
Past experience:											
1940	\$592	\$550		\$42	\$28	\$16			\$12		\$564
1945	1,434	1,310		124	267	240			27		1,167
1950	2,367	2,106	\$4	257	784	727			57		1,583
1955	5,525	5,087		438	4,427	4,333			103		1,098
1960	10,360	9,843		517	11,073	10,270			202		-713
1965	16,443	15,857		586	15,962	15,226			300		482
1966	18,461	17,866		595	18,769	18,071			254		308
1967	23,371	22,567		726	19,728	18,886			334		308
1968	23,640	22,662	78	899	21,622	20,737	(3)		447		3,643
1969	27,348	25,953	156	1,014	24,690	23,732	\$2		465		2,018
1970	31,746	29,955	78	1,350	27,321	26,267	1		474		2,558
1971	33,982	31,915	78	1,618	32,268	31,101	2		552		3,616
1972	37,917	35,711	137	1,719	35,849	34,541	2		582		1,714
1973	43,639	41,318	138	1,847	43,623	42,170	2		667		2,068
1974	50,936	48,455	139	2,039	49,485	47,849	4		723		1,451
Estimated future experience: ⁴											
1975	58,545	55,809	140	2,289	56,775	54,927	7		881	960	39,637
1976	60,779	58,125	157	2,229	64,544	62,535	9		970	1,030	35,872
July-September 1976	15,806	15,702		104	17,311	17,068	2		241		-3
1977	70,795	68,184	303	2,027	74,195	71,690	10		1,053	1,452	34,367
1978	78,529	76,187	311	1,809	82,285	79,840	12		1,149	1,284	30,897
1979	86,730	84,696	314	1,486	90,923	88,286	13		1,243	1,381	27,141
					50,923	48,286	13		1,493		22,944

¹ Under the Congressional Budget Act of 1974 (Public Law 93-344), fiscal years 1977 and later consist of the 12 months ending on Sept. 30 of each year. The Act further provides that the calendar quarter July-September 1976 is a period of transition from fiscal year 1976, which ends on June 30, 1976, to fiscal year 1977, which begins on Oct. 1, 1976.

² Interest on investments includes net profits on marketable investments. Total administrative expenses exclude expenses for the period ending Dec. 31, 1939; for that period, appropriations to the old-age and survivors insurance trust fund (designated as the old-age reserve account prior to Jan. 1, 1940) were approximately equivalent to tax contributions collected by the Treasury Department less administrative expenses. Beginning in 1954, administrative expenses include costs of construction of office space for the Social Security Administration. Beginning in 1967, administrative expenses incurred

under each of the 4 programs, old-age and survivors insurance, disability insurance, hospital insurance and supplementary medical insurance, are charged currently to the appropriate trust fund on an estimated basis, with a final adjustment, including interest, made in the following fiscal year. The amounts of these interest adjustments are included in interest on investments. For years prior to 1967, a description of the method of accounting for administrative expenses is contained in the 1970 annual Report of the Board of Trustees.

³ Less than \$500,000.

⁴ In interpreting the estimates, reference should be made to the accompanying text which describes the underlying assumptions.

Estimated income from contributions reflects the increases in estimated taxable earnings described above and, in addition, the scheduled changes in the allocation of the contribution rates between the old-age and survivors insurance and disability insurance trust funds effective January 1, 1978 (table 1).

Rising benefit disbursements during fiscal years 1975-79 reflect the effects of the future automatic benefit increases previously set forth, as well as the long-range upward trend in the numbers of beneficiaries and in the amounts of average monthly earnings underlying benefits payable under the program. In each fiscal year during the period 1976-79, outgo from the old-age and survivors insurance trust fund is estimated to exceed income. During the entire period covering fiscal years 1975-79, there is an estimated net decrease in the old-age and survivors insurance trust fund of \$14.9 billion.

Estimates consistent with those shown on a fiscal-year basis in table 10 are presented in table 11 to show the progress of the old-age and survivors insurance trust fund on a calendar-year basis. During the 5-year period covering calendar years 1975-79, the trust fund is estimated to decline by \$19.6 billion from \$37.8 billion at the end of calendar year 1974 to \$18.2 billion at the end of calendar year 1979.

TABLE 11.—OPERATIONS OF THE OLD-AGE AND SURVIVORS INSURANCE TRUST FUND DURING SELECTED CALENDAR YEARS 1940-74 AND ESTIMATED FUTURE OPERATIONS DURING CALENDAR YEARS 1975-79

[In millions]

Calendar year	Transactions during period											
	Income			Disbursements								
	Reimbursements from general fund of Treasury for costs of—			Interest on investments	Total	Benefit payments	Payments for vocational rehabilitation services	Administrative expenses	Transfers to railroad retirement account	Net increase in fund	Fund at end of period	
	Contributions, less refunds	Noncon- tributory credits for military service	Payments to persons noninsured aged 72 and over									
Past experience:												
1940.....	\$368	\$325	—	\$43	\$62	\$35	—	\$26	—	\$306	\$2,031	
1945.....	1,420	1,285	—	134	304	274	—	30	—	1,116	7,121	
1950.....	2,928	2,667	—	257	1,022	961	—	61	—	1,905	13,721	
1955.....	6,167	5,713	\$4	454	5,079	4,968	—	119	—	1,087	21,663	
1960.....	11,382	10,866	—	516	11,198	10,677	—	203	—	1,184	20,324	
1965.....	16,610	16,017	—	593	17,501	16,737	—	328	—	—	18,235	
1966.....	21,302	20,580	—	644	18,967	18,267	—	256	—	—	20,570	
1967.....	24,034	23,138	78	818	20,362	19,468	(1)	406	—	2,335	26,572	
1968.....	25,040	23,719	156	939	23,557	22,642	\$1	476	—	3,652	30,082	
1969.....	29,554	27,947	78	1,165	25,176	24,209	1	474	—	4,378	30,082	
1970.....	32,220	30,256	78	1,515	29,848	28,796	2	471	—	2,371	32,454	
1971.....	35,877	33,723	137	1,667	34,542	33,413	2	514	—	1,335	33,789	
1972.....	40,050	37,781	138	1,794	38,522	37,122	2	674	—	1,528	35,318	
1973.....	48,344	45,975	139	1,928	47,175	45,741	3	647	—	1,169	36,487	
1974.....	54,688	52,081	140	2,159	53,397	51,618	5	865	—	1,291	37,777	
Estimated future experience:												
1975.....	58,610	55,891	157	2,394	60,773	58,888	8	917	960	—	35,614	
1976.....	62,788	61,199	303	2,045	68,072	66,022	10	1,010	1,030	—	31,330	
1977.....	72,169	69,797	311	1,839	76,198	73,660	11	1,075	1,452	—	27,301	
1978.....	80,095	77,943	314	1,594	84,404	81,944	12	1,164	1,284	—	22,932	
1979.....	88,178	86,426	320	1,265	92,957	90,339	14	1,263	1,381	—	13,173	

¹ Less than \$500,000.

Note: In interpreting the above, reference should be made to the footnotes in table 10.

The growth in the number of beneficiaries in the past and the expected growth in the future are attributable in large measure to the rising number of aged persons who are eligible for and receiving old-age and survivors insurance benefits. The growth in the number of eligible persons since 1940 has been uninterrupted. This growth results partly from the increase in the aged population and partly from two other factors—(1) in each passing year a larger proportion of the persons attaining age 65 became eligible for benefits, and (2) the amendments during the period 1950-73 liberalized the eligibility provisions and extended coverage to new categories of employment.

In addition, there has been a growth in the proportion of eligible persons who receive benefits. This growth is due to several factors, among which are (1) the amendments enacted during the period 1950-73 which affect the conditions governing the receipt of benefits, and (2) the increasing percentage of eligible persons who are aged 72 and over and who therefore receive benefits regardless of earnings.

The expected operations and status of the disability insurance trust fund during fiscal years 1975-79 are presented in table 12, together with the figures on actual experience in earlier years. Contribution income will increase during fiscal years 1975-79 reflecting the same factors, insofar as they apply to contributions to the disability insurance trust fund, that are reflected in the increase in contributions to the old-age and survivors insurance trust fund during the same period. Beginning January 1, 1978, contribution income will also be increased as a result of the scheduled increase from 1.15 percent to 1.20 percent in the combined employee-employer contribution rate allocated for disability insurance. (This increase is exactly counterbalanced by a decrease in the rate allocated for old-age and survivors insurance.) Benefit payments will increase because of automatic benefit increases and because of increases in the numbers of beneficiaries and in the amounts of average monthly earnings on which benefits are based. Outgo from the disability insurance trust fund is expected to exceed income in each year during the period covering fiscal years 1975-79. During this period, the assets of the trust fund are estimated to decline by \$6.8 billion.

TABLE 12.—OPERATIONS OF THE DISABILITY INSURANCE TRUST FUND DURING SELECTED FISCAL YEARS 1960-74 AND ESTIMATED FUTURE OPERATIONS DURING FISCAL YEARS 1975-79

Fiscal year ¹	Transactions during period										
	Income			Disbursements							
	Total	Contributions, less refunds	Reimbursements from general fund of Treasury for cost of noncontributory credits for military service	Interest on investments ²	Total	Benefit payments	Payments for vocational rehabilitation services	Administrative expenses ²	Transfers to railroad retirement account	Net increase in fund	Fund at end of period
Past experience: ³											
1960	\$1,034	\$987		\$47	\$533	\$528		\$32	-\$27	\$501	\$2,167
1965	1,237	1,175		62	1,495	1,392		79	24	-257	2,007
1966	1,611	1,557		54	1,931	1,721		183	25	-321	1,686
1967	2,332	2,249		83	2,636	2,443	\$1	99	31	-222	2,022
1968	2,800	2,699	\$16	105	3,236	2,988	7	112	20	564	2,585
1969	3,705	3,532	32	141	4,413	4,043	15	133	21	1,092	3,678
1970	4,380	4,141	16	223	5,254	4,778	16	149	10	1,426	5,104
1971	4,911	4,569	16	325	6,065	5,381	21	190	13	1,305	6,408
1972	5,291	4,853	50	388	6,309	5,646	28	212	24	982	7,390
1973	5,947	5,461	51	435	7,047	6,359	50	247	39	479	8,253
1974	6,768	6,234	52	482	7,985	7,159	67	262	20	-77	8,176
Estimated future experience: ⁴											
1975	7,908	7,342	52	514	9,420	8,420	90	295	15	-1,224	6,952
1976	8,196	7,641	90	465	9,420	8,420	90	295	15	-518	6,434
July-September 1976	2,080	2,064		16	2,598	2,499	26	73		-1,587	4,847
1977	9,443	8,957	104	382	11,030	10,579	115	319	17	-1,584	3,263
1978	10,769	10,375	119	275	12,353	11,859	131	349	14	-1,824	1,439
1979	11,928	11,682	125	121	13,752	13,221	147	374	10		

¹ Under the Congressional Budget Act of 1974 (Public Law 93-344), fiscal years 1977 and later consist of the 12 months ending on Sept. 30 of each year. The Act further provides that the calendar quarter July–September 1976 is a period of transition from fiscal year 1976, which ends on June 30, 1976, to fiscal year 1977, which begins on Oct. 1, 1976.

² Interest on investments includes net profits on marketable investments. Beginning in 1967, administrative expenses incurred under the disability insurance program are charged directly to the trust fund on a current (preliminary) basis, with a final adjustment, including interest, made in the following fiscal year. The amounts of these interest adjustments are included in interest on investments. For years prior to 1967, a description of the method of accounting for administrative expenses is contained in the 1970 Annual Report of the Board of Trustees.

³ The financial operations of the disability insurance trust fund began in the latter half of fiscal year 1957.

⁴ In interpreting the estimates, reference should be made to the accompanying text which describes the underlying assumptions.

Estimates consistent with those shown on a fiscal-year basis in table 12 are presented in table 13 to show the progress of the disability insurance trust fund on a calendar-year basis. During the 5-year period covering calendar years 1975-79, the assets of the trust fund are estimated to decline by \$7.7 billion from \$8.1 billion at the end of calendar year 1974 to \$0.4 billion by the end of calendar year 1979.

The expected operations and status of the old-age and survivors insurance and disability insurance trust funds, combined, during each year 1975-79 are shown in tables 14 and 15 on a fiscal-year basis and a calendar-year basis, respectively, together with figures on actual experience in earlier years.

TABLE 13.—OPERATIONS OF THE DISABILITY INSURANCE TRUST FUND DURING SELECTED CALENDAR YEARS 1960-74 AND ESTIMATED FUTURE OPERATIONS DURING CALENDAR YEARS 1975-79

[In millions]

Calendar year	Income					Disbursements					Transfers to railroad retirement account	Net increase in fund	Fund at end of period
	Transactions during period					Benefit payments	Payments for vocational rehabilitation services	Administrative expenses					
	Total	Contributions, less refunds	Reimbursements from general fund of Treasury for costs of noncontributory credits for military service	Interest on investments	Total								
Past experience:													
1960	\$1,063	\$1,010	-----	\$53	\$600	\$568	-----	\$36	\$5	\$464	\$2,289		
1965	1,247	1,188	-----	59	1,687	1,573	-----	90	24	440	1,606		
1966	2,079	2,006	-----	58	1,947	1,781	-----	137	25	133	1,739		
1967	2,379	2,286	\$16	78	2,089	1,939	\$3	109	31	290	2,029		
1968	3,454	3,316	32	106	2,458	2,294	16	127	20	996	3,025		
1969	3,752	3,599	16	177	2,716	2,542	15	138	21	1,075	4,100		
1970	4,774	4,481	16	277	3,259	3,067	18	164	10	1,514	5,614		
1971	5,031	4,620	50	361	4,000	3,758	24	205	13	1,031	6,645		
1972	5,572	5,107	51	414	4,759	4,473	29	233	20	813	7,457		
1973	6,443	5,932	52	458	5,973	5,718	46	190	24	470	7,927		
1974	7,378	6,826	52	500	7,196	6,903	54	217	22	182	8,109		
Estimated future experience:													
1975	7,938	7,347	90	501	8,752	8,378	78	276	20	814	7,295		
1976	8,555	8,044	104	407	10,060	9,640	99	306	15	505	5,790		
1977	9,603	9,173	119	311	11,350	10,888	119	326	17	747	4,043		
1978	11,051	10,714	125	212	12,709	12,205	135	355	14	658	2,385		
1979	12,131	11,921	133	77	14,095	13,553	151	381	10	964	421		

Note: In interpreting the above, reference should be made to the footnotes in table 12.

TABLE 14.—OPERATIONS OF THE OLD-AGE AND SURVIVORS INSURANCE AND THE DISABILITY INSURANCE TRUST FUNDS, COMBINED, DURING SELECTED FISCAL YEARS 1960-74 AND ESTIMATED FUTURE OPERATIONS DURING FISCAL YEARS 1975-79

(In millions)

Fiscal year	Transactions during period											
	Income					Disbursements						
	Total	Contributions, less refunds	Reimbursements from general fund of Treasury for costs of—		Interest on investments	Total	Benefit payments	Payments for vocational rehabilitation services	Administrative expenses	Transfers to railroad retirement account	Net increase in funds	Funds at end of period
			Non-tributory credits for military service	Payment to non-insured persons aged 72 and over								
Past experience:												
1960	\$11,394	\$10,830	—	—	\$564	\$11,606	\$10,798	—	\$234	\$574	—\$212	\$22,996
1961	17,681	17,032	—	—	648	17,456	16,618	—	379	459	224	22,187
1965	20,071	19,423	—	—	649	20,700	19,793	—	437	469	—629	21,558
1966	25,703	24,816	—	—	793	21,725	20,747	\$1	433	539	3,979	25,537
1967	26,440	25,362	94	—	984	23,859	22,825	16	560	458	2,581	28,118
1968	31,054	29,485	188	—	1,155	27,303	26,175	17	599	513	3,750	31,868
1969	36,127	34,096	94	—	1,572	30,275	29,045	18	623	589	5,852	37,720
1970	38,893	36,485	94	371	1,943	35,874	34,482	23	742	626	3,019	40,739
1971	43,208	40,564	187	351	2,107	40,158	38,587	29	794	749	3,050	43,789
1972	49,586	46,779	189	337	2,281	49,090	47,332	42	914	802	496	44,285
1973	57,704	54,689	191	303	2,521	55,869	54,007	54	878	931	1,835	46,120
1974	—	—	—	—	—	—	—	—	—	—	—	—
Estimated future experience:												
1975	66,453	62,151	192	307	2,803	64,760	62,563	75	1,142	980	1,693	47,813
1976	68,975	65,766	247	268	2,694	73,964	71,555	99	1,265	1,045	—4,989	42,824
July-September 1976	17,886	17,766	—	—	120	19,909	19,567	28	314	—	—2,023	40,801
1977	80,168	77,111	407	241	2,409	85,225	82,259	125	1,372	1,469	—5,057	35,744
1978	89,298	86,562	430	222	2,084	94,638	91,699	143	1,498	1,298	—5,340	30,404
1979	98,658	96,368	439	244	1,607	104,675	101,507	160	1,617	1,391	—6,017	24,387

Note: In interpreting the above, reference should be made to the footnotes in table 10.

TABLE 15.—OPERATIONS OF THE OLD-AGE AND SURVIVORS INSURANCE AND THE DISABILITY INSURANCE TRUST FUNDS, COMBINED, DURING SELECTED CALENDAR YEARS 1960-74 AND ESTIMATED FUTURE OPERATIONS DURING CALENDAR YEARS 1975-79

[In millions]

Calendar year	Transactions during period										
	Income			Disbursements							
	Reimbursements from general fund of Treasury for costs of—			Interest on investments	Total	Benefit payments	Payments for vocational rehabilitation services	Administrative expenses	Transfers to railroad retirement account	Net increase in funds	
	Contributions, less refunds	Noncon-tributory credits for military service	Payments to non-insured persons aged 72 and over								
Past experience:											
1960.....	\$12,445	\$11,876	—	\$569	\$11,798	\$11,245	—	\$240	\$314	\$647	\$22,613
1965.....	17,857	17,205	—	651	19,187	18,311	—	418	459	1,331	19,841
1966.....	23,381	22,585	—	702	20,913	20,048	—	393	469	2,467	22,308
1967.....	26,413	25,424	—	896	22,471	21,406	—	515	539	3,942	26,250
1968.....	28,493	27,034	—	1,045	26,015	24,936	17	603	458	2,479	28,729
1969.....	33,346	31,546	\$226	1,342	27,892	26,751	16	612	513	5,453	34,182
1970.....	36,993	34,737	364	1,791	33,108	31,863	20	635	589	3,886	38,068
1971.....	40,908	38,343	371	2,027	38,542	37,171	26	719	626	2,366	40,434
1972.....	45,622	42,888	337	2,208	43,281	41,595	30	907	749	2,341	42,775
1973.....	54,787	51,907	303	2,386	53,148	51,459	49	837	802	1,639	44,414
1974.....	62,066	58,907	307	2,660	60,593	58,521	59	1,082	931	1,472	45,886
Estimated future experience:											
1975.....	66,548	63,238	268	2,795	69,525	67,266	86	1,193	980	-2,977	42,909
1976.....	72,343	69,243	241	2,452	78,132	75,662	109	1,316	1,045	-5,789	37,120
1977.....	81,772	78,970	222	2,150	87,548	84,548	130	1,401	1,469	-5,776	31,344
1978.....	91,146	88,657	244	1,806	97,113	94,149	147	1,519	1,298	-5,967	25,377
1979.....	100,309	96,347	167	1,342	107,092	103,892	165	1,644	1,391	-6,783	18,594

Note: In interpreting the above, reference should be made to the footnotes in table 10.

The estimates in the tables in this section include the effects of various provisions to which reference has been made in earlier sections, namely, the provisions for (1) reimbursements to the trust funds from the general fund of the Treasury for the costs of granting noncontributory credits for military service and for the costs of monthly payments to certain noninsured persons aged 72 and over, and (2) financial interchanges between the railroad retirement account and the trust funds.

Expenditures in calendar year 1974, from both trust funds combined, were 9.82 percent of taxable earnings for the year and are estimated to increase to 10.90 percent in 1975 and to 11.05 percent in 1976. The percentage will decline somewhat after 1976, as estimated taxable earnings increase at a relatively greater rate than estimated expenditures. These percentages, as well as the actual percentages for earlier years, are shown in table 16 for both trust funds combined and for each trust fund separately. The following table shows, for each of the years 1975-79, the extent to which the percentage for both trust funds combined exceeds the combined employee-employer contribution rate:

[In percent]

Calendar year	Expenditures as a percentage of taxable payroll	Combined employee- employer contribution rate	Difference
1975	10.90	9.90	-1.00
1976	11.05	9.90	-1.15
1977	10.87	9.90	-.97
1978	10.75	9.90	-.85
1979	10.73	9.90	-.83

The ratio of assets at the beginning of the year to expenditures during the year for both trust funds combined is estimated to be about 0.66 for calendar year 1975. The ratio will drop each year, as the assets of the trust funds decline during the 5-year period 1975-79; and by calendar year 1979, the ratio is estimated to be 0.24. The estimated ratio for each of the 5 calendar years 1975-79, as well as the actual ratio for earlier years, is shown in table 17 for both trust funds combined and for each trust fund separately.

TABLE 16.—EXPENDITURES FROM THE OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS AS A PERCENTAGE OF TAXABLE PAYROLL FOR SELECTED CALENDAR YEARS 1960-74 AND ESTIMATED FUTURE PERCENTAGES FOR CALENDAR YEARS 1975-79

Calendar year	Expenditures as a percentage of taxable payroll ¹		
	Old-age and survivors insurance and disability insurance trust funds, combined	Old-age and survivors insurance trust fund	Disability insurance trust fund
Past experience:			
1960.....	5.89	5.59	0.30
1965.....	7.93	7.23	.70
1966.....	6.88	6.24	.64
1967.....	6.92	6.27	.65
1968.....	7.03	6.35	.67
1969.....	7.08	6.38	.70
1970.....	8.13	7.32	.81
1971.....	9.22	8.26	.96
1972.....	9.15	8.13	1.01
1973.....	9.71	8.61	1.10
1974.....	9.82	8.65	1.17
Estimated future experience: ²			
1975.....	10.90	9.52	1.38
1976.....	11.05	9.62	1.43
1977.....	10.87	9.46	1.41
1978.....	10.75	9.34	1.41
1979.....	10.73	9.31	1.41

¹ Percentage takes into account (1) the lower contribution rate payable by the self-employed compared with combined employee-employer rate, (2) employee contributions subject to refund, and (3) that for 1966 and later, only the employee contribution is payable on tips taxable as wages. Beginning in 1966, expenditures are adjusted to exclude payments to certain noninsured persons aged 72 and over with less than 3 quarters of coverage, costs of which are financed from the general fund of the Treasury. For 1970-74, percentages are preliminary and subject to revision.

² In interpreting the estimates, reference should be made to the accompanying text which describes the underlying assumptions.

TABLE 17.—ASSETS, AT THE BEGINNING OF THE YEAR, AS A PERCENTAGE OF EXPENDITURES DURING THE YEAR, FOR THE OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROGRAM, BY TRUST FUND, FOR SELECTED CALENDAR YEARS 1960-74, AND ESTIMATED FUTURE PERCENTAGES FOR CALENDAR YEARS 1975-79

Calendar year	Assets, at the beginning of the year, as a percentage of expenditures during the year		
	Old-age and survivors insurance and disability insurance trust funds, combined	Old-age and survivors insurance trust fund	Disability insurance trust fund
Past experience:			
1960.....	186	180	304
1965.....	110	109	121
1966.....	95	96	83
1967.....	99	101	83
1968.....	101	103	83
1969.....	103	102	111
1970.....	103	101	126
1971.....	99	94	140
1972.....	93	88	140
1973.....	80	75	125
1974.....	73	68	110
Estimated future experience: ¹			
1975.....	66	62	93
1976.....	55	52	73
1977.....	42	41	51
1978.....	32	32	32
1979.....	24	25	17

¹ In interpreting the estimates, reference should be made to the accompanying text which describes the underlying assumptions.

Estimates of trust fund operations presented in this report show substantial declines in the assets of both trust funds during the next 5-year period, as already noted. It is apparent that without legislation to provide additional financing, the trust funds' assets will be exhausted soon after 1979. Under the assumptions on which the estimates in this section are based, the assets of the disability insurance trust fund will be exhausted in 1980, and the assets of the old-age and survivors insurance trust fund will be exhausted shortly thereafter. The expected substantial decline in the assets of the trust funds during 1975-79, which was not anticipated in the 1974 annual report, is attributable primarily to (1) the reduction in contribution income resulting from lower levels of employment and taxable earnings due to the current recession, and (2) the greater-than-expected upward movement in the CPI, with the result that automatic benefit increases assumed herein are larger than were previously assumed.

ACTUARIAL ANALYSIS OF BENEFIT DISBURSEMENTS FROM THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE TRUST FUND WITH RESPECT TO DISABLED BENEFICIARIES

(Specifically required by Sec. 201(c) of the Social Security Act)

Effective January 1957, monthly benefits have been payable from the old-age and survivors insurance trust fund to disabled adult children aged 18 and over—sons and daughters of retired and deceased workers—with respect to disabilities that have continued since childhood. Effective February 1968, reduced monthly benefits have been payable from this trust fund to disabled widows and widowers beginning at age 50.

On December 31, 1974, about 410,000 persons were receiving monthly benefits from the old-age and survivors insurance trust fund with respect to disability. In addition to disabled beneficiaries, this total includes 37,000 mothers. These mothers—wives under age 65 of retired-worker beneficiaries and widows of deceased insured workers—met all other qualifying requirements and were receiving full-rate (i.e., not reduced for age) benefits solely because they had at least one disabled-child beneficiary in their care. Benefits paid from this trust fund to persons receiving benefits with respect to disability totaled \$567 million in calendar year 1974. Similar figures are presented in table 18 to show the experience in each of the calendar years 1957-74.

Table 18 also shows the expected future experience in calendar years 1975-79. Total benefit payments from the old-age and survivors insurance trust fund with respect to disabled beneficiaries are estimated to increase from \$651 million in calendar year 1975 to \$1,075 million in calendar year 1979.

TABLE 18.—BENEFITS PAYABLE FROM THE OLD-AGE AND SURVIVORS INSURANCE TRUST FUND WITH RESPECT TO DISABLED BENEFICIARIES, CALENDAR YEARS 1957-79
[Beneficiaries in thousands; benefit payments in millions]

Calendar year	Disabled beneficiaries, end of year			Amount of benefit payments ¹		
	Total	Children ²	Widows and widowers	Total	Children ²	Widows and widowers ³
Past experience:						
1957.....	34	34	-----	\$7	\$7	-----
1958.....	59	59	-----	23	23	-----
1959.....	94	94	-----	41	41	-----
1960.....	117	117	-----	59	59	-----
1961.....	138	138	-----	74	74	-----
1962.....	163	163	-----	89	89	-----
1963.....	183	183	-----	101	101	-----
1964.....	200	200	-----	113	113	-----
1965.....	214	214	-----	134	134	-----
1966.....	228	228	-----	147	147	-----
1967.....	243	243	-----	163	163	-----
1968.....	275	256	19	212	198	\$14
1969.....	301	270	31	249	214	35
1970.....	320	284	36	301	260	41
1971.....	338	298	40	363	307	56
1972.....	363	317	46	409	343	66
1973.....	384	333	51	502	417	85
1974.....	410	357	53	567	479	88
Estimated future experience: ⁴						
1975.....	432	376	56	651	553	98
1976.....	456	397	59	744	633	111
1977.....	481	419	62	844	721	123
1978.....	507	442	65	956	820	136
1979.....	535	467	68	1,075	927	148

¹ Beginning in 1966, includes payments for vocational rehabilitation services.

² Reflects effect of including certain mothers. (See text.)

³ Reflects the offsetting effect of lower benefits payable to disabled widows and widowers who continue to receive benefits past age 60 (62, for disabled widowers, prior to 1973) as compared to the higher nondisabled widow's (and widower's) benefits that would otherwise be payable.

⁴ Reflects the assumed changes under the automatic increase provisions that were described in the preceding section.

In calendar year 1974, benefit payments (including expenditures for vocational rehabilitation services) with respect to disabled persons from the old-age and survivors insurance trust fund and from the disability insurance trust fund (including payments from the latter fund to all dependents of disabled-worker beneficiaries) totalled \$7,524 million, of which \$567 million, or 7.5 percent, represented payments from the old-age and survivors insurance trust fund. Similar figures for all of the calendar years 1957-79 are presented in table 19.

TABLE 19.—BENEFIT PAYMENTS UNDER THE OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROGRAM WITH RESPECT TO DISABLED BENEFICIARIES, BY TRUST FUND, CALENDAR YEARS 1957-79

[In millions]

Calendar year	Benefit payments ¹ from—			
	Total ¹	Disability insurance trust fund ²	Old-age and survivors insurance trust fund	As a percentage of total benefit payments with respect to disabled beneficiaries
			Amount ³	
Past experience:				
1957.....	\$64	\$57	\$7	11.1
1958.....	272	249	23	8.5
1959.....	498	457	41	8.2
1960.....	627	568	59	9.4
1961.....	961	887	74	7.7
1962.....	1,194	1,105	89	7.4
1963.....	1,311	1,210	101	7.7
1964.....	1,422	1,309	113	8.0
1965.....	1,707	1,573	134	7.9
1966.....	1,932	1,784	147	7.6
1967.....	2,113	1,950	163	7.7
1968.....	2,523	2,311	212	8.4
1969.....	2,806	2,557	249	8.9
1970.....	3,386	3,085	301	8.9
1971.....	4,146	3,783	363	8.8
1972.....	4,911	4,502	409	8.3
1973.....	6,266	5,764	502	8.0
1974.....	7,524	6,957	567	7.5
Estimated future experience: ⁴				
1975.....	9,107	8,456	651	7.1
1976.....	10,483	9,739	744	7.1
1977.....	11,851	11,007	844	7.1
1978.....	13,296	12,340	956	7.2
1979.....	14,779	13,704	1,075	7.3

¹ Beginning in 1966 includes payments for vocational rehabilitation services.² Benefit payments to disabled workers and their dependents.³ Benefit payments to disabled children aged 18 and over, to certain mothers (see text), and to disabled widows and widowers (see footnote 3, table 18).⁴ Reflects the assumed changes under the automatic increase provisions that were described in the preceding section.

LONG-RANGE ACTUARIAL STATUS OF THE TRUST FUNDS

Significance of Long-Range Cost Estimates

Long-range cost estimates are essential to the evaluation and planning of the OASDI program over the long-range future. Such estimates are of necessity based on a number of demographic and economic assumptions.

While it is not possible to accurately predict the future, it is possible to make long-range cost estimates based upon reasonable assumptions which will indicate the trend and general range in future costs. Such cost estimates, and their underlying assumptions, if revised periodically in the light of developing trends, provide valuable information for use in policy decision-making.

Since future demographic and economic experience may differ considerably from any single set of assumptions on which cost estimates are based, long-range cost estimates have been prepared on the basis of a wide range of assumptions, some of which are presented in the body of the Report and some of which are summarized in Appendix A.

Long-Range Cost Estimates

The estimates of the long-range cost of the old-age, survivors, and disability insurance system presented in this Report are based on present law. Therefore, if future legislation results in changes in benefits or in the financing provisions, the cost of the program will change and new cost estimates will be required.

The long-range cost estimates are computed under dynamic assumptions with respect to the future increases in the benefit levels and in the taxable earnings base under the automatic adjustment provisions in present law. These provide for automatically adjusting the benefit table in accordance with the Consumer Price Index and for automatically adjusting the taxable earnings base in accordance with the increase in average covered earnings per worker. It should be noted here, however, that the Board is recommending a modification in the provisions of law so as to avoid the probability of future unintended and excessively costly benefit payments that could result from the way in which the automatic adjustments are now designed. This proposal is discussed below in more detail.

The cost estimates are presented herein under three alternative sets of economic assumptions. The central set of assumptions is based on annual increases of 6 percent in average earnings and 4 percent in the Consumer Price Index throughout the period 1981–2049. Because of the high degree of uncertainty in any long-range economic forecast, two alternative sets of economic assumptions are also used. These alternatives fall on either side of the central assumptions, with one alternative based on a 5 percent annual increase in earnings and a 3 percent annual CPI increase, while the other set uses 7 percent wage and 5 percent CPI assumptions. These alternatives are presented following the description and analyses of the system under the central assumptions, and a comparison of all of the results obtained under all three sets is found in table 23. In all, higher assumptions are used in the period 1975–80. An earlier section of this Report dealing with the “Expected Operations and Status of the Trust Funds During the Period, July 1, 1974, to December 31, 1979”, discusses the higher assumptions in the early years, which are used with respect to the long-range central set of economic assumptions.

Table 20 contains a projection of the future expenditures of the old-age, survivors, and disability insurance system as percent of taxable payroll under the central set of economic assumptions. According to this projection the cost of the old-age and survivors insurance program will increase slowly during the remainder of this century. After the turn of the century, the cost will be subject to accelerated increases until leveling at about 18½ percent of taxable payroll around the year 2030. For the disability insurance program the projection shows a steady increase in cost to around the year 2020, after which the cost will level at about 3¾ percent of taxable payroll.

The combined cost of the total old-age, survivors, and disability insurance system, using the central set of economic assumptions, is projected to increase to about 12 percent of taxable payroll by the end of the century; thereafter the costs will increase rapidly to about 22 percent of taxable payroll by the year 2030 and will remain essentially

level during the remainder of the valuation period. These future costs would be substantially ameliorated, however, if the provisions of law were modified to avoid the phenomenon that causes future projected benefits under the automatic adjustment provisions to increase out of proportion to the levels of wage replacement established by benefits currently paid under the program. (The expected costs under the assumption of a change in law are set forth in tables 24 and 25, below, with accompanying text.)

Table 20 also compares for selected years the projected expenditures as percent of taxable payroll and the tax rates that are scheduled in present law. In every year in the future the projected cost exceeds the scheduled tax rate. The excess increases with time and is projected to reach levels of about 10 percent of taxable payroll or higher after the year 2030.

TABLE 20.—ESTIMATED EXPENDITURES OF OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE SYSTEM AS PERCENT OF TAXABLE PAYROLL¹ FOR SELECTED YEARS, 1985-2050

[In percent]

Calendar year	Expenditures as percent of taxable payroll ²			Tax rate in law	Difference
	Old-age and survivors insurance	Disability insurance	Total		
1985	9.24	1.69	10.93	9.90	-1.03
1990	9.28	1.94	11.22	9.90	-1.32
1995	9.49	2.15	11.64	9.90	-1.74
2000	9.50	2.50	12.00	9.90	-2.10
2005	9.81	2.95	12.76	9.90	-2.86
2010	10.77	3.36	14.13	9.90	-4.23
2015	12.44	3.63	16.07	11.90	-4.17
2020	14.58	3.76	18.34	11.90	-6.44
2025	16.74	3.71	20.45	11.90	-8.55
2030	18.15	3.60	21.75	11.90	-9.85
2035	18.61	3.59	22.20	11.90	-10.30
2040	18.41	3.70	22.11	11.90	-10.21
2045	18.26	3.86	22.12	11.90	-10.22
2050	18.51	3.93	22.44	11.90	-10.54
Averages as percent of taxable payroll:					
1975-99	9.35	1.81	11.16	9.90	-1.26
2000-24	11.99	3.13	15.12	11.02	-4.10
2025-49	18.18	3.91	22.09	11.90	-10.19
Average-current-cost: ³ 1975-2049	13.29	2.97	16.26	10.94	-5.32

¹ Payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.

² Calculated under the central set of economic assumptions of annual increases after 1980 of 6 percent in average earnings and 4 percent in CPI. Higher assumptions are used in the 1975-80 period.

³ "Average-current-cost" represents the arithmetic average of expenditures as percent of taxable payroll for the period and includes the cost of increasing the funds on hand to 1-yr expenditures by the end of the valuation period.

Table 21 compares the average tax rate in the present law with the expenditures as percent of taxable payroll of the old-age, survivors, and disability insurance system projected under the central set of assumptions for three successive periods of 25 years beginning in 1975. In addition, the table compares the average tax rate and average-current-cost of the system over the customary 75-year period (1975-2049). According to these calculations the old-age, survivors, and disability insurance system is estimated to be underfinanced over the

customary long-range 75-year period by an average annual amount equivalent to 5.32 percent of taxable payroll. Over the first 25-year period the cost would exceed taxes by an average annual amount equivalent to 1.26 percent of taxable payroll; over the second 25-year period it would exceed them by an average annual amount equivalent to 4.10 percent of taxable payroll; and over the third 25-year period it would exceed them by an average annual amount equivalent to 10.19 percent of taxable payroll. In all cases the underfinancing is more pronounced for the disability insurance program than for the old-age and survivors insurance program when viewed as a proportion of the cost of each program.

TABLE 21.—COMPARISON OF EXPENDITURES ¹ AND TAXES FOR OLD-AGE, SURVIVORS AND DISABILITY INSURANCE SYSTEM AS PERCENT OF TAXABLE PAYROLL ²

[In percent]

Item	Average for item as percent of taxable payroll		
	Old-age and survivors insurance	Disability insurance	Total
1st 25-yr period (1975-99):			
Expenditures as percent of taxable payroll	9.35	1.81	11.16
Tax rate in law	8.57	1.33	9.90
Difference	-.78	-.48	-1.26
2d 25-yr period (2000-24):			
Expenditures as percent of taxable payroll	11.99	3.13	15.12
Tax rate in law	9.45	1.57	11.02
Difference	-2.54	-1.56	-4.10
3d 25-yr period (2025-49):			
Expenditures as percent of taxable payroll	18.18	3.91	22.09
Tax rate in law	10.20	1.70	11.90
Difference	-7.98	-2.21	-10.19
Total 75-yr period (1975-2049):			
Current-cost ³	13.29	2.97	16.26
Tax rate in law	9.41	1.53	10.94
Actuarial balance	-3.88	-1.44	-5.32

¹ Calculated under the central set of economic assumptions of annual increases after 1980 of 6 percent in average earnings and 4 percent in CPI. Higher assumptions are used in the 1975-80 period.

² Payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple employer "excess wages" as compared with the combined employer-employee rate.

³ "Average-current-cost" represents the arithmetic average of expenditures as percent of taxable payroll for the period and includes the cost of increasing the funds on hand to 1 yr expenditures by the end of the valuation period.

The results in tables 20 and 21 are based on new actuarial assumptions as compared to those used in last year's report with respect to demographic factors as well as economic factors. In regard to demographic factors, new population projections were prepared which take into account comments and suggestions made by the panel of experts appointed by the Senate Committee on Finance to review the costs estimates presented in last year's report. The effect of the demographic changes as well as changes in economic and other assumptions on the long-range 75-year actuarial balance may be observed in table 22.

TABLE 22.—CHANGE IN OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE LONG-RANGE ACTUARIAL BALANCE¹ AS PERCENT OF TAXABLE PAYROLL² BY TYPE OF ASSUMPTION

[In percent]

Item	Old-age and survivors insurance	Disability insurance	Total
Actuarial balance estimated in last year's report.....	-2.58	-0.40	-2.98
Demographic assumptions.....	-.20	-.04	-.24
Female labor force participation.....	+.33	+.02	+.35
Economic assumptions.....	-1.54	-.41	-1.95
Disability rates.....	-0.0	-.60	-.60
All other assumptions (net).....	+.11	-.01	+.10
Change in actuarial balance.....	-1.30	-1.04	-2.34
New estimated actuarial balance.....	-3.88	-1.44	-5.32

¹ Based on 75-yr period of valuation and calculated under the central set of economic assumptions of annual increase after 1980 of 6 percent in average earnings and 4 percent in CPI. Higher assumptions are used in the 1975-80 period.

² Payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.

With respect to economic factors, it is assumed that:

(a) The female labor force participation rates will increase faster than previously projected. The new projections are based on a 23 percent ultimate increase in age-adjusted rates over the rates experienced in 1974.

(b) Through 1980 the assumptions are the same as those used in developing the short-range cost estimates, which are presented earlier in this report.

(c) Beyond 1980, average earnings will increase at an annual rate of 6 percent, while the CPI will increase at 4 percent.

(d) Beyond 1980, unemployment will average 5 percent.

In the preparation of the disability insurance cost estimates the assumed rates at which workers become disabled and the rates at which their benefits are later terminated due to either death or recovery from the disability, are updated to reflect the actual experience through calendar year 1974. In addition, it is assumed that the rate at which benefits are being awarded will increase 3 percent per year for the next 5 years.

The effect of these changes in assumptions as measured by the 75-year long-range actuarial balance is shown in table 22, which traces that balance from the estimate presented in last year's report to the estimate presented in this report under the central set of assumptions.

The results in tables 20, 21 and 22 should be read with full recognition of the uncertainties involved in the projection of economic and demographic factors over long-range periods. Because of the sensitivity of the projections to changes in economic assumptions, these results are subject to wide margins of variation. Because of the high degree of uncertainty in long-range economic forecasts, calculations were done under two alternative sets of assumptions. These alternatives fall on either side of the central set of assumptions. These are displayed in table 23 which provides an indication of the effect of changes in the assumed annual increase in CPI. All three projections displayed in the table are based on annual increases in real earnings of about 2 percent. The cost figures shown in the middle column (that is, those based on the central set of assumptions) are the same as those shown in

table 20. However, the range of variation shown in table 23 should not be interpreted as depicting the complete range of all conceivable alternative outcomes. Such a range would be wider than that shown by the table. For example, if fertility rates were to continue to decline as they have over the last decade, and if economic conditions which have prevailed over the past few years were treated as normal and extrapolated to continue over the next 75 years, the long-range actuarial deficit of the old-age, survivors, and disability insurance program would be higher than projected under any of the alternatives in table 23. Conversely, if these demographic and economic factors were extrapolated into the future on the basis of experience over the longer term past, rather than just the last decade, the projected 75-year deficit would be lower. Measures of the effect of variation in the assumed increases in real earnings, fertility and migration are provided in Appendix A of this report.

TABLE 23.—ESTIMATED EXPENDITURES OF OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE SYSTEM AS PERCENT OF TAXABLE PAYROLL ¹ UNDER VARIOUS ECONOMIC ASSUMPTIONS, FOR SELECTED YEARS, 1985-2050

[In percent]

Calendar year	Expenditures as percent of taxable payroll under assumptions of— ²		
	5-3	6-4	7-5
1985.....	10.99	10.93	10.89
1990.....	11.20	11.22	11.25
1995.....	11.49	11.64	11.79
2000.....	11.68	12.00	12.34
2005.....	12.21	12.76	13.34
2010.....	13.29	14.13	14.99
2015.....	14.90	16.07	17.30
2020.....	16.74	18.34	20.03
2025.....	18.40	20.45	22.66
2030.....	19.26	21.75	24.43
2035.....	19.39	22.20	25.21
2040.....	19.06	22.11	25.30
2045.....	18.90	22.12	25.49
2050.....	19.03	22.44	26.04
Average of expenditures as percent of taxable payroll:			
1975-99.....	11.12	11.16	11.19
2000-24.....	14.31	15.12	16.42
2025-49.....	19.05	22.09	24.91
Average-current-cost: ³ 1975-2049.....	14.93	16.26	17.68

¹ Payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.

² The initial value in each set refers to the assumed annual percent increases after 1980 in average earnings, while the second value in each set refers to the assumed percent increases after 1980 in CPI. Higher assumptions are used in the 1975-80 period.

³ "Average-current-cost" represents the arithmetic average of expenditures as percent of taxable payroll for the period and includes the cost of increasing the funds on hand to 1 yr's expenditures by the end of the valuation period.

It will be observed that the 75-year average-current-cost of 16.26 percent of taxable payroll estimated under the central set of assumptions would be reduced to 14.93 percent of taxable payroll if the CPI is assumed to increase at 3 percent per year. Similarly, the 75-year average-current-cost would increase to 17.68 percent of taxable payroll if the CPI is assumed to increase at 5 percent per year. This means that the 75-year actuarial balance of -5.32 percent of taxable payroll shown in table 21 would decrease to -3.99 percent of taxable payroll or increase to -6.74 percent of taxable payroll if the assumed annual increase in CPI and in average-earnings were lowered or raised by one percent from the values used in the central set of assumptions.

One significant element of the sensitivity of the projected costs to economic assumptions is the fact that most of the effect of changes in the CPI occurs after the turn of the century. The expenditures as percent of taxable payroll of the old-age, survivors, and disability insurance system over the remainder of the 20th century, that is, over the 26-year period, 1975-1999, would vary only from a low of 11.12 percent of taxable payroll to a high of 11.19 percent of taxable payroll according to the assumptions displayed in table 23. Since variations in other elements in the cost projection (mostly in demographic elements) would have only minor effects on the cost of the system over the 25-year period, it can be concluded that over the remainder of this century the old-age, survivors, and disability insurance system will need additional financing equivalent to about 1.3 percent of taxable payroll under reasonable sets of economic assumptions.

After the turn of the century, the amount of required additional financing would be significantly higher as may be noted from the projections in table 23. However, to a large extent, the higher cost that is projected to occur after the turn of the century is due to what may be considered unintended and undesirable results of the automatic benefit adjustment provisions in present law.

These present provisions in the law automatically increase the benefits of retired workers as increases occur in the CPI. These CPI increases are also given (indirectly through increases in the benefit table) to workers who have not yet retired and who therefore have an opportunity to improve their future benefits as a result of increases in their future taxable earnings. Thus, in a large proportion of cases the future benefits of those who are still working increase at annual rates that are in excess of increases in either CPI or average wages under economic conditions which may be considered likely to prevail. The duality of benefit increases that is possible under present law can result in future benefits being substantially higher than the highest gross earnings on which the worker was taxed.

For illustrative purposes, cost projections are presented in table 24 under alternative economic assumptions (the same ones used in table 23) and under a modified theoretical old-age, survivors, and disability insurance system which would maintain through time the relationship between average awarded benefits and average earnings existing at the beginning of calendar year 1977. It is assumed that in this theoretical system, as is true in present law, benefits after retirement would be increased automatically to keep up with increases in CPI. The new system is assumed to apply to insured workers who attain age 62, die or become disabled after 1976. These individuals would receive the higher of benefits determined under the new procedure for computing benefits or the procedure and benefit table in the law at the end of 1976.

TABLE 24.—ESTIMATED EXPENDITURES OF A MODIFIED THEORETICAL OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE SYSTEM¹ AS PERCENT OF TAXABLE PAYROLL² UNDER VARIOUS ECONOMIC ASSUMPTIONS, FOR SELECTED YEARS, 1985-2050

[In percent]

Calendar year	Expenditures as percent of taxable payroll under assumptions of— ³		
	5-3	6-4	7-5
1985	11.01	10.90	10.79
1990	11.24	11.10	10.98
1995	11.60	11.45	11.32
2000	11.74	11.59	11.45
2005	12.03	11.88	11.73
2010	12.76	12.60	12.45
2015	13.99	13.81	13.65
2020	15.48	15.29	15.11
2025	16.82	16.60	16.40
2030	17.44	17.22	17.01
2035	17.37	17.15	16.95
2040	16.90	16.68	16.48
2045	16.57	16.36	16.16
2050	16.53	16.32	16.12
Average of expenditures as percent of taxable payroll:			
1975-99	11.17	11.06	10.95
2000-24	13.63	13.43	13.28
2025-49	16.95	16.78	16.56
Average-current-cost: 4 1975-2049	14.00	13.83	13.67

¹ See text for brief description of theoretical system.

² Payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.

³ The initial value in each set refers to the assumed annual percent increases after 1980 in average earnings, while the second value in each set refers to the assumed percent increases after 1980 in CPI. Higher assumptions are used in the 1975-80 period.

⁴ "Average-current-cost" represents the arithmetic average of expenditures as percent of taxable payroll for the period and includes the cost of increasing the funds on hand to 1 yr's expenditures by the end of the valuation period.

It may be observed from table 24 that the long-range cost of the modified theoretical old-age, survivors, and disability insurance system would be relatively insensitive to changes in the CPI assumption. According to the three sets of economic assumptions shown in the table, the average-current-cost over the customary 75-year period would be about 13.7 to 14.0 percent of taxable payroll.

Table 25 shows the estimated cost over various periods under the modified theoretical system. Under the assumptions used the actuarial imbalance over the customary 75-year period would be reduced to about -2.7 to -3.1 percent of taxable payroll if the system is modified to maintain through time the relationship between average awarded benefits and average earnings that will prevail at the beginning of calendar year 1977. The table also compares over three successive 25-year periods starting in 1975 the estimated average expenditures as percent of taxable payroll and the average-tax rate scheduled in present law.

TABLE 25.—COMPARISON OF EXPENDITURES AND TAXES FOR A MODIFIED THEORETICAL OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE SYSTEM¹ AS PERCENT OF TAXABLE PAYROLL² UNDER VARIOUS ECONOMIC ASSUMPTIONS

Item	[In percent]		
	Average for item as percent of taxable payroll under assumptions of— ³		
	5-3	6-4	7-5
1st 25-yr period (1975-99):			
Expenditures as percent of taxable payroll.....	11.17	11.06	10.95
Tax rate in law.....	9.96	9.90	9.90
Difference.....	-1.27	-1.16	-1.05
2d 25-yr period (2000-24):			
Expenditures as percent of taxable payroll.....	13.63	13.43	13.28
Tax rate in law.....	11.02	11.02	11.02
Difference.....	-2.61	-2.41	-2.26
3d 25-yr period (2025-49):			
Expenditures as percent of taxable payroll.....	16.95	16.78	16.56
Tax rate in law.....	11.90	11.90	11.90
Difference.....	-5.05	-4.88	-4.66
Total 75-yr period (1975-2094):			
Current-cost ⁴	14.00	13.83	13.67
Tax rate in law.....	10.94	10.94	10.94
Actuarial balance.....	-3.06	-2.89	-2.73

¹ See text for brief description of theoretical system.

² Payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.

³ The initial value in each set refers to the assumed annual percent increases after 1980 in average earnings, while the second value in each set refers to the assumed percent increases after 1980 in CPI. Higher assumptions are used in the 1975-80 period.

⁴ "Average-current-cost" represents the arithmetic average of expenditures as percent of taxable payroll for the period and includes the cost of increasing the funds on hand to 1 yr's expenditures by the end of the valuation period.

It may also be observed from table 25 that over the next 25-year period the expenditures as percent of taxable payroll of the old-age, survivors, and disability insurance system is projected to exceed the taxes scheduled in present law under all economic assumptions used. These costs are similar to those projected under present law, which are shown in table 23. Under the modified theoretical system the additional taxes required over the remainder of this century would be about 1.1 to 1.3 percent of taxable payroll, whereas under present law it would be about 1.2 to 1.3 percent of taxable payroll.

It may be concluded from the cost analyses presented in this Report that the expenditures of the old-age, survivors, and disability insurance system for the remainder of the 20th century will exceed the taxes now scheduled in present law under reasonable sets of economic assumptions and irrespective of a possible modification in the automatic benefit adjustment provisions. If the system is to meet its outlays for the remainder of this century, higher taxes equivalent to an increase of about 1.3 percent of taxable payroll will be required.

ADVISORY COUNCIL ON SOCIAL SECURITY

Pursuant to section 706 of the Social Security Act, an Advisory Council on Social Security was appointed by the Secretary of Health, Education, and Welfare in April, 1974. The Council submitted its reports on March 6, 1975. The following two recommendations of the

Council would have a very significant impact on the financing of the program and the future integrity of the trust funds:

1. *Benefit structure—replacement rates. The provisions of present law for computing average monthly earnings, on which benefits are based, and for adjusting the benefit table in the law to changes in prices may result over the long range in unintended, unpredictable, and undesirable variations in the level of benefits. The benefit structure should be revised to maintain the levels of benefits in relation to pre-retirement earnings levels that now prevail. Benefits for workers coming on the rolls in the future should be computed on the basis of a revised benefit formula using past earnings indexed to take account of changes during their working lives in the average earnings of all covered workers. As under present law, benefits for people on the rolls should continue to be increased as price levels increase.*

Revising the benefit structure to stabilize replacement rates as recommended by the Advisory Council, would substantially reduce the sensitivity of the future cost of the system to the complex interaction of economic factors. It would also significantly reduce the rapid escalation of cost in the old-age, survivors, and disability insurance system projected to occur after the turn of the century. The Board of Trustees recommends revision of the benefit structure in order to achieve stability of benefit levels relative to prior earnings. The precise method of accomplishing this goal is now under study.

2. *Employee-employer taxes. The OASDI tax rate should be gradually increased, as OASDI costs increase, and the increases should be met by reallocating taxes now scheduled in the law for part A (hospital insurance) of the Medicare program. Income lost to the hospital insurance program by this reallocation should be made up from the general funds of the Treasury.*

Additional revenues for the social security cash benefits program will be required in both the short-range and long-range under all foreseeable circumstances. The Board recommends that additional revenue requirements be met through increased contribution rates, an increase in the earnings base or some combination of these elements. The Board is opposed to the use of additional general revenue financing for the social security program.

The Council also made a recommendation concerning the OASDI contribution rates for the self-employed. The Council proposed: *The present 7-percent limitation on the tax rate for the self-employed should be removed. The self-employment OASDI tax rate should be the same multiple of the employee contribution rate as was fixed at the time the self-employed were first covered—150 percent.*

The Board of Trustees supports this recommendation and recommends its adoption by the Congress.

Additional recommendations were made by the Advisory Council regarding the extension of social security protection through various changes in the provisions governing coverage and eligibility for benefits. The Board cautions that, as the Administration and the Congress consider these recommendations, the financial status of the OASDI system and the financial implications of the recommendations should be fully taken into account.

CONCLUSION

The short-range actuarial cost estimates indicate that the assets of both the old-age, and survivors insurance trust fund and the disability insurance trust fund will decline during the 5-year period 1975-79. Without legislation to provide additional financing, the assets of both trust funds will be exhausted soon after 1979.

The Board recommends that prompt action be taken to strengthen the financing of the old-age, survivors, and disability insurance system over the near term. The required additional income to the trust funds should be obtained through increases in the tax rate, in the taxable earnings base, or in both rate and base. The Board opposes the use of additional general revenue financing for the old-age, survivors, and disability insurance program. The Board noted that the amount of additional income required for the program would be reduced if the Congress adopted the President's proposal to limit to 5 percent the automatic benefit increase scheduled for June, 1975.

The long-range actuarial cost estimates indicate that for every year in the future the estimated expenditures will exceed the estimated income from taxes. This excess increases with time and is estimated to average about 1.3 percent of taxable payroll over the next 25-year period (1975-1999). All reasonable alternative actuarial assumptions indicate that over the remainder of this century the financing of the old-age, survivors, and disability insurance program will need additional revenues equivalent to about 1.3 percent of taxable payroll.

The long-range cost of the OASDI program projected to occur after the turn of the century will substantially exceed the taxes scheduled in present law. Although those projected costs are highly sensitive to variations in the actuarial assumptions, all reasonable assumptions indicate that there will be significant excesses of expenditures over income. This report is not intended to provide an indication of the fullest possible range of variation in the long-range cost estimates. (Appendix A provides some information on the sensitivity of the long-range cost estimates to alternative assumptions.)

To some extent the high cost of the old-age, survivors, and disability insurance program projected to occur after the turn of the century is due to unintended results in the automatic benefit adjustment provisions enacted in 1972, which cause future projected benefits to increase out of proportion to levels of wage replacement established by benefits currently paid under the program. The Board fully concurs with the intent of the recommendation by the 1975 Advisory Council on Social Security that the benefit structure be revised to maintain the levels of benefits in relation to preretirement earnings levels that now prevail.

The Board recommends that development of specific plans for strengthening of the long-range financing of the old-age, survivors, and disability insurance program be pursued immediately with special priorities given to ways of modifying the automatic benefit adjustment provisions in present law.

In this regard, the Board is pleased to note that the Administration has already begun studies of the possible means of accomplishing this objective. The Board also welcomes the cooperative efforts now under way between the Social Security Administration and the actuarial and economic consultants appointed by the Congressional Research

Service of the Library of Congress at the request of the House Committee on Ways and Means and the Senate Committee on Finance to study this matter.

The Board also concurs with the 1975 Advisory Council on Social Security in the recommendation that the OASDI tax rate applicable to self-employment income be set at a level equivalent to 150 percent of the tax rate applicable to wages.

APPENDIXES

APPENDIX A.—STATEMENT OF ASSUMPTIONS, METHODOLOGY, AND DETAILS OF LONG-RANGE COST ESTIMATES

(Prepared by Office of the Actuary—Social Security Administration)

The basic assumptions used in the long-range estimates for the old-age, survivors, and disability insurance system are described in this appendix. Also given here are some detailed data in connection with the results of these estimates.

Section A of this appendix provides a description of the demographic aspects of the long-range cost estimates. Section B discusses the economic and various other aspects of the long-range cost estimates. The terms "demographic" and "economic" are used in a general sense, since it is not entirely possible to separate the effect of these two aspects on the cost estimates. "Demographic aspects" refer to those elements dealing with the population and its characteristics. These elements include the number, age, sex, marital status, retirement, disability, mortality, fertility, employment, and coverage under the system. "Economic aspects" refer to the projected annual increases in the Consumer Price Index (CPI) and in the average earnings in covered employment. Section C of this appendix contains a brief analysis of the sensitivity of the cost projections to changes in selected demographic and economic assumptions.

A. DEMOGRAPHIC ASPECTS

This section of the appendix discusses the methods used to estimate the demographic elements of the OASDI cost projections.

(1) POPULATION

A projection was made of the United States population (including persons overseas covered by the old-age, survivors, and disability insurance program) for future quinquennial years, by 5-year age groups and by sex. The starting point was the population on July 1, 1973, as estimated by the Bureau of the Census from the 1970 Census and from births, deaths, and migration in 1970-73. This population estimate was adjusted for differences in the geographical areas covered by the estimate of the Bureau of the Census and those covered by the old-age, survivors, and disability insurance system.

In the population projection it was assumed that through 2050 mortality rates will continue the general trends established over the period from 1950-1970. This results in an overall reduction in mortality rates of about 15 percent from 1970 to 2050.

The total fertility rate was assumed to decrease from its current level to a level of 1.7 children per woman in fiscal year 1977 and then slowly increase to an ultimate level of 2.1 children per woman in fiscal year 2005. It was assumed to remain level at 2.1 from 2005 to 2050. The 2.1 ultimate total fertility rate is close to population replacement rate and would ultimately result in close-to-zero population growth. In addition, the projection assumed a small amount of net immigration. Appendix table A presents the projected population by broad age groups. Complete details about the population projection will be given in a new actuarial study to be published by the Social Security Administration.

APPENDIX TABLE A.—PROJECTIONS OF THE U.S. POPULATION BY BROAD AGE GROUPS, 1985-2050

Year	Population (in thousands) as of July 1				65 and over as—	
	Under 20	20 to 64	65 and over	Total	Percent of total	Ratio of 20 to 64
1985	70,754	141,512	26,741	239,006	11.2	0.189
1990	71,929	147,457	28,789	248,176	11.6	.195
1995	74,264	152,261	30,015	256,540	11.7	.197
2000	76,333	157,038	30,214	263,585	11.5	.192
2005	76,349	162,970	30,580	269,898	11.3	.188
2010	76,222	167,432	32,662	276,316	11.8	.195
2015	76,990	168,840	36,917	282,747	13.1	.219
2020	78,561	167,873	42,061	288,494	14.6	.251
2025	80,030	165,608	47,448	293,087	16.2	.287
2030	80,768	164,636	51,227	296,632	17.3	.311
2035	81,202	166,502	51,879	299,583	17.3	.312
2040	81,989	169,501	50,806	302,296	16.8	.300
2045	83,213	172,462	49,257	304,931	16.2	.286
2050	84,462	173,843	49,352	307,657	16.0	.284

(2) EMPLOYMENT

Assumptions as to the percentage of the population who have covered employment during a year were made for each age group by sex for each quinquennial year. For men, the latest estimated average percentages (1970-72) were projected to increase for teenagers, to decrease slightly for those aged 20-59, and to decrease significantly for those aged 60 and over (thus recognizing the trend toward higher retirement rates). For women, the corresponding percentages were assumed to increase, except for those aged 60 and over for whom a decrease was projected.

As measured by the age-adjusted labor force participation rates for ages 16 and over, the projected ultimate covered employment is equivalent to a decrease over the rates experienced in calendar year 1974 of about 2 percent for males and an increase of about 23 percent for females. At the ultimate assumed rates females would have, on the average, participation in the labor force that is about 73 percent of male participation rates.

The foregoing projections are consistent with the projected average unemployment rate of 5 percent. It is assumed that any periods during which unemployment is substantially higher than the assumed level would be of relatively short duration or would be balanced by offsetting periods of low unemployment, and would therefore have virtually no long-range cost effect.

(3) INSURED POPULATION

The term "insured" as used herein means fully insured, since the number of persons who are currently-insured only is relatively small and can be disregarded for long-range cost analysis purposes. The number of insured persons as percent of population by age and sex, in various future years is estimated from recent experience and from the projected coverage. It is evident that eventually almost all males in the country will be insured for old-age and survivors benefits; the ultimate percentage for aged males is estimated at 95 percent. For females it is estimated that the corresponding proportion will eventually be 85 percent. This is lower than for males because of the lower participation rates of females in the labor force.

The estimated numbers of persons insured for disability benefits are lower than those insured for old-age and survivor benefits because of the more restrictive insured status provision for disability benefits. These numbers were also estimated on the basis of recent experience and the projected percentage of persons covered.

(4) OLD-AGE AND SURVIVORS INSURANCE BENEFICIARIES

Old-age beneficiaries were estimated from the aged insured population. The proportions, by age and sex, of the insured population that were receiving benefits at the beginning of 1973 were projected to increase according to past trends after adjustment for changes in the earnings test and in the level of unemployment, thereby reflecting assumed gradual increases in the retirement rates.

Wives aged 62 and over of male old-age beneficiaries were estimated by using census data and mortality projections. These potential wife beneficiaries, after adjustment for eligibility for their own old-age benefits, were assumed to claim benefits as soon as they are eligible, even if this occurred at ages 62-64, when they would have to take reduced benefits. The experience to date indicates that in the vast majority of the cases, such immediate claiming of wife's benefits does occur.

Young wives and children of retired workers were estimated by reference to their ratios to male old-age beneficiaries, as derived from recent actual data and projected according to the aforementioned fertility and mortality assumptions.

Child-survivor beneficiaries were obtained from estimates of orphans in the country in future years. The projected child population, by age group, was multiplied by the probability of being an orphan. These probabilities were derived by using distribution of age of parent at birth of child and death rates consistent with the population projections. The number of orphans was then adjusted to eliminate orphans of uninsured deceased parents, and to include the eligible disabled orphans aged 18 and over. For non-disabled children aged 18-21 a further reduction was made to exclude those not attending school. Mother-survivor-beneficiaries were estimated by extrapolating the present ratio of mothers to children, after excluding those non-disabled children 18-21 who were attending school, to reflect the projected fertility. The estimated costs were increased by 0.01 percent of taxable payroll to reflect the cost of fathers survivors benefits, payable as a result of the recent Supreme Court decision.

To estimate widow beneficiaries the proportions of widows in the female aged population were projected according to mortality assumptions and adjusted for both eligibility for their own old-age benefits and for the insured status of their deceased husbands. These uninsured eligible widows were assumed to claim benefits as soon as available even if this occurred at ages 60 to 64, when they would have to take reduced benefits. For ages 50-59, the disabled widow beneficiaries were estimated from the eligible widows by using disability prevalence rates.

It may be observed that the assumed wife and widow beneficiaries consist of the uninsured potential beneficiaries. In actual practice, some of the insured potential beneficiaries also receive a residual benefit consisting of the excess of the potential wife's or widow's benefit over their own old-age benefit. These residual benefits, although not giving rise to additional aged beneficiaries, were considered in the cost of the particular type of dependent or survivor benefit concerned.

The minor category of parent beneficiaries was projected by assuming a decrease from a level of 23,000 at the end of 1974 to an ultimate level of 15,000 in 1980. The insignificant effect of the retirement test as it applies to wife's, widow's and parent's benefits was ignored. No separate estimates were made for benefits to dependent husbands and widowers since their cost is relatively negligible.

Appendix table B shows the estimated number of beneficiaries in the old-age and survivors insurance program.

APPENDIX TABLE B.—OLD-AGE AND SURVIVORS INSURANCE BENEFICIARIES WITH MONTHLY BENEFITS IN CURRENT-PAYMENT STATUS ¹

[In thousands]

Calendar year	Retired workers and dependents			Survivors of deceased workers				Total
	Old-Age	Wives ²	Children	Mothers	Children	Widows ³	Parents	
Actual data (as of June 30):	-	-	-	-	-	-	-	-
1970.....	13,066	2,651	535	514	2,673	3,151	29	22,619
1971.....	13,604	2,673	556	523	2,745	3,287	28	23,416
1972.....	14,181	2,706	578	536	2,847	3,433	27	24,308
1973.....	14,880	2,756	602	548	2,887	3,575	25	25,273
1974.....	15,589	2,806	619	565	2,908	3,620	24	26,131
Projection (as of June 30):	-	-	-	-	-	-	-	-
1985.....	21,243	2,892	518	765	3,035	3,686	15	32,154
1990.....	23,319	2,897	387	777	3,030	3,610	15	34,035
1995.....	24,589	2,898	310	824	3,253	3,514	15	35,403
2000.....	25,172	2,766	311	849	3,526	3,452	15	36,091
2305.....	26,310	2,528	345	855	3,662	3,417	15	37,132
2010.....	29,077	2,352	416	832	3,636	3,394	15	39,722
2015.....	33,623	2,317	496	815	3,614	3,345	15	44,225
2020.....	39,120	2,302	577	819	3,679	3,339	15	49,851
2025.....	44,427	2,288	623	834	3,777	3,326	15	55,290
2030.....	47,655	2,247	619	843	3,833	3,327	15	58,539
2035.....	48,513	2,121	590	836	3,842	3,262	15	59,179
2040.....	47,506	1,969	552	823	3,853	3,225	15	57,943
2045.....	46,689	1,841	551	829	3,906	3,153	15	56,984
2050.....	47,020	1,809	577	837	3,978	3,070	15	57,306

¹ Excluding the effect of the railroad financial interchange provisions.² Including dependent husband beneficiaries.³ Including dependent widower beneficiaries.

(5) LUMP-SUM DEATH PAYMENTS

The numbers of lump-sum death payments were estimated by multiplying the insured population by the death rates used in the population projections.

(6) DISABILITY INSURANCE BENEFICIARIES

The future number of persons receiving monthly disability benefits based on their own earnings was estimated by the application of incidence and termination rates. These rates were developed from the experience data available from the operations of the disability insurance system. The population insured for disability (by sex and age) was multiplied by the incidence rates to arrive at the number of new cases of disabled workers. These in turn were projected through the use of mortality and recovery termination rates to obtain the number of beneficiaries.

The assumed incidence rates were based on the estimated actual experience in calendar year 1965, adjusted to reflect both the increases in awarded disability benefits through the end of calendar year 1974 as well as relevant legislated changes through that year. Although the reasons for these increases are not yet fully understood, it was decided that the projected costs should reflect the total increases that have already been experienced through the end of calendar year 1974. In addition, the incidence rates were assumed to increase 3 percent per year for the next 5 years and to remain level thereafter. This extrapolation of future incidence rates is intended as a temporary procedure for reflecting probable future increases.

A more complete knowledge of possible future trends in the number of disabled worker beneficiaries will not be available until current studies of the recent increases are completed.

The mortality and recovery rates were based on the actual experience of the system for the period 1957-67 adjusted to reflect the estimated experience through the end of calendar year 1974.

The number of child beneficiaries was projected as a proportion of the disabled male beneficiaries allowing for future projected changes in fertility.

The number of wife beneficiaries was projected as a proportion of child beneficiaries after allowing the projected future changes in fertility.

Appendix table C shows the projected number of beneficiaries in the disability insurance program.

APPENDIX TABLE C.—DISABILITY INSURANCE BENEFICIARIES WITH MONTHLY BENEFITS IN CURRENT-PAYMENT STATUS¹

[In thousands]

Calendar year	Workers	Wives ²	Children	Total
Actual data (as of June 30):				
1970.....	1,436	271	861	2,568
1971.....	1,561	293	934	2,788
1972.....	1,737	327	1,028	3,092
1973.....	1,925	364	1,127	3,416
1974.....	2,098	391	1,203	3,692
Projection (as of June 30):				
1985.....	3,829	533	1,302	5,664
1990.....	4,219	516	1,151	5,886
1995.....	4,675	631	1,340	6,646
2000.....	5,379	758	1,632	7,769
2005.....	6,240	906	1,964	9,110
2010.....	6,982	1,034	2,289	10,305
2015.....	7,397	1,060	2,434	10,891
2020.....	7,448	1,007	2,440	10,895
2025.....	7,146	942	2,338	10,426
2030.....	6,796	889	2,224	9,909
2035.....	6,706	884	2,194	9,784
2040.....	6,868	896	2,242	10,006
2045.....	7,131	914	2,325	10,370
2050.....	7,231	904	2,357	10,492

¹ Excluding the effect of the railroad financial interchange provisions.² Including dependent husband beneficiaries.

B. ECONOMIC ASPECTS; MISCELLANEOUS ASPECTS

This section of the appendix presents a discussion of the economic aspects and miscellaneous aspects of the OASDI long-range cost estimates. As stated above, the term "economic aspects" is used here to refer primarily to the assumptions regarding future annual increases in average earnings as well as in the Consumer Price Index (CPI). The importance of these economic aspects results from the automatic adjustment provisions in the present law which require that the benefit table be adjusted to keep up with increases in the CPI and that the taxable earnings base, as well as the exempt amount in the retirement test, be adjusted to keep up with increases in average earnings. This type of automatic procedure has the effect that, once a worker retires, the value of his benefits will not deteriorate in terms of purchasing power. It has the further effect that, for those who are still working, their potential benefits increase because of both the increases in the credited earnings and the adjustment in the benefit table according to increases in the CPI. This dual increase in potential benefits for future beneficiaries may, in combination, be at a higher or lower rate than the increase in earnings, but (as will be shown later) it is likely to be, on the average, slightly higher than increases in earnings for the next 20 years and significantly higher thereafter.

(1) ECONOMIC ASSUMPTIONS AS TO ANNUAL INCREASES IN AVERAGE EARNINGS AND IN CPI

The cost estimates presented in the Report are based on three alternative sets of economic assumptions as described therein. This was done to illustrate the effect on the estimates of variations in economic assumptions. However, most of the estimates presented in the report are based on the central set of economic assumptions in which the ultimate annual rate of increase in average earnings is assumed to be 6 percent while CPI is assumed to increase at 4 percent.

The assumed 4 percent increase in the CPI is approximately $\frac{1}{2}$ of one percent higher than has been experienced over the last 30 years. However, trends over the last 60 years indicate a tendency for the CPI to increase slowly with time. Moreover, current outlook does not support a reversal or a halt in these trends. The assumed 6-percent increase in average earnings is a by-product of the 4-percent CPI assumption and the assumption adopted regarding the annual increases in average real earnings. Based on the trend in real earnings over the last 20-25 years, and also on the assumption that there would be a leveling in the movement toward part-time employment, an ultimate annual increase in

average real earnings of 2 percent was adopted. This increase when combined with the assumed CPI increase of 4 percent yielded the assumption of a total increase in average earnings of 6 percent.

This central set of economic assumptions is consistent with the economic assumptions adopted by the panel of actuaries and economists appointed in 1974 by the Senate Committee on Finance to review the OASDI long-range cost estimates published in last year's report of the Board of Trustees.¹

Unless otherwise stated, the estimates presented in this appendix are based on this same central set of economic assumptions, that is, ultimate annual increases in average earnings in covered employment of 6 percent and in the CPI of 4 percent. For years before 1981 the assumptions are as described in the section of this report dealing with the 5-years forecast of operation of the trust funds.

(2) AVERAGE BENEFITS

Appendix table D shows the projected average awarded retirement benefit, the projected average retirement benefit in current-payment status, and the projected increases in each as compared to increases in average earnings. As can be observed from the projected ratios in the third column of the table, all of which are greater than one, the average awarded retirement benefit is projected to increase faster than average earnings. It can also be observed that this is particularly true after the year 1995 when the computation period for retirement benefits reaches its ultimate length of 35 years.

To prepare the figures in appendix table D, the average awarded benefits for retired workers were projected by computer simulation of the automatic adjustment provisions for workers at various earnings levels under the central set of economic assumptions regarding the increases in earnings and CPI. The average benefits in current-payment status were then obtained by weighting the projected awarded benefits according to values obtained from recent actual experience while allowing for the effect of future CPI adjustments.

APPENDIX TABLE D.—PROJECTED INCREASES IN AVERAGE RETIREMENT BENEFIT AT AWARD AND IN CURRENT-PAYMENT STATUS AS COMPARED WITH PROJECTED INCREASES IN AVERAGE COVERED EARNINGS¹ FOR SELECTED YEARS, 1975-2050

Calendar year	Average annual retirement benefit		Ratio of increase in retirement benefits to increase in earnings	
	Awards	In current payment	Awards	In current payment
1975	2,750	2,603	1.000	1.000
1985	5,921	5,001	1.060	.946
1990	8,020	6,832	1.066	.960
1995	10,832	9,280	1.074	.972
2000	15,206	12,643	1.126	.989
2005	21,517	17,521	1.191	1.024
2010	29,769	24,504	1.231	1.070
2015	41,038	34,136	1.268	1.114
2020	56,399	47,218	1.302	1.152
2025	77,431	65,014	1.336	1.185
2030	106,166	89,316	1.369	1.217
2035	145,696	122,569	1.404	1.248
2040	198,435	167,970	1.429	1.278
2045	269,841	229,422	1.452	1.304
2050	366,258	312,401	1.473	1.327

¹ Based on the central set of economic assumptions of annual increases of 4 percent in CPI and 6 percent in earnings and somewhat higher increases before 1981. The benefits refer only to those payable to retired workers. The figures in the column entitled "In current-payment" refer to the average benefits for all retired workers who are receiving benefits, while those in the column entitled "Awards" refer to the average benefits for those workers retiring in the particular year.

(3) TOTAL BENEFIT PAYMENTS

Total benefit payments were calculated as the product of the number of beneficiaries and their corresponding average benefits. These values were adjusted to reflect retroactive payments.

¹ The panel's discussion of these assumptions may be found on pp. 10-11 under the sub-headings "Rate of Growth in Real Wages" and "Rate of Inflation" of the Report of the Panel on Social Security Financing to the Committee on Finance United States Senate, printed for the Committee, February 1975.

(4) ADMINISTRATIVE EXPENSES

It was assumed that future administrative expenses would be 1.8 percent of benefit payments for old-age and survivors insurance and 5.0 percent of benefit payment for disability insurance. These percentages include the allocation of funds to be used to rehabilitate disabled beneficiaries under the beneficiary rehabilitation program enacted in 1965.

(5) RAILROAD RETIREMENT FINANCIAL INTERCHANGE

The effect of the financial interchange was evaluated on the basis of trends similar to those used for the old-age, survivors, and disability insurance direct costs. This results in a small long-range loss to the Old-Age, Survivors, and Disability System.

(6) INTEREST RATE

The interest rate used in each estimate and projection was assumed at an annual real rate (after discounting for CPI increases) of $3\frac{1}{4}$ percent.

The effect of a different interest rate would be minor since the system is expected to operate with relatively small trust funds.

C. SENSITIVITY OF COST ESTIMATES TO CHANGES IN SELECTED ASSUMPTIONS

(1) SENSITIVITY TO ECONOMIC ASSUMPTIONS

This subsection contains a brief analysis of the sensitivity of the cost projections to some changes in the economic assumptions and to changes in procedures for computing benefits.

Appendix table E shows the average-cost over periods of 25 years (1975-1999), 50 years (1975-2024) and 75 years (1975-2049) under three alternative assumptions of annual CPI increases of 3 percent, 4 percent, and 5 percent. In each case the annual increases in real average earnings are assumed at about 2 percent yielding annual increases in average earnings of 5 percent, 6 percent and 7 percent. The table indicates the cost under present law as well as under a modified theoretical system in which average benefits awarded at retirement are assumed to increase after 1976 at about the same rate as average earnings. In this modified theoretical system it is also assumed, as is true in present law, that after retirement, benefits will be increased automatically to keep up with increases in CPI. The new theoretical system is assumed to apply to individuals who attain age 62, die or become disabled after 1976. These individuals would have a choice between the new procedure for computing benefits or the procedure and benefit table in the law at the end of 1976.

APPENDIX TABLE E.—ESTIMATED LONG-RANGE AVERAGE-CURRENT-COST¹ OF OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE SYSTEM AS PERCENT OF TAXABLE PAYROLL,² UNDER VARIOUS CPI ASSUMPTIONS,³ PRESENT LAW AND MODIFIED THEORETICAL SYSTEM⁴

[In percent]

System	Estimated under assumptions of— ³		
	5-3	6-4	7-5
25-yr period:			
Present law	11.39	11.42	11.47
Modified theoretical	11.43	11.31	11.20
50-yr period:			
Present law	12.93	13.50	14.10
Modified theoretical	12.57	12.43	12.30
75-yr period:			
Present law	14.93	16.26	17.68
Modified theoretical	14.00	13.83	13.67

¹ "Average-current-cost" represents the arithmetic average of expenditures as percent of taxable payroll for the period and includes the cost of increasing the funds on hand to 1 yr's expenditures by the end of the valuation period.

² Payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.

³ The initial value in each set refers to the assumed annual percent increases after 1980 in average earnings, while the 2d value in each set refers to the assumed percent increases after 1980 in CPI. Higher assumptions are used in the 1975-80 period.

⁴ See text for brief description of theoretical system.

As shown in appendix table E the average-cost of the old-age, survivors, and disability insurance system over a 75-year period under present law is highly sensitive to changes in CPI assumptions. However, under the modified theoretical system the average-cost would be significantly less sensitive to CPI assumptions.

It will be noted that under the modified theoretical system the average-cost decreases with increases in CPI. This is due in large part to specific assumptions used in this case in which there is a lag between the increases in earnings and the assumed increases in average awarded benefits. Normally, costs are computed as a percent of the taxable payroll in the year, while awarded benefits normally are based on earnings in years prior to retirement.

A very significant element in appendix table E is the fact that over the rest of this century, that is, for the next 25-year period, the average-cost of the old-age, survivors, and disability insurance system will be essentially the same (11.2 to 11.5 percent of taxable payroll) regardless of the CPI assumption or of a possible modification in the procedure for computing benefits.

Appendix table F shows the average-cost over periods of 25 years, 50 years and 75 years under three alternative assumptions of annual increases in average real earnings of 1½ percent, 2 percent and 2½ percent. In each case the annual increases in average earnings of 5½ percent, 6 percent, and 6½ percent. The table indicates the cost under the present law as well as under the modified theoretical system previously discussed.

APPENDIX TABLE F.—ESTIMATED LONG-RANGE AVERAGE-CURRENT-COST¹ OF OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE SYSTEM AS PERCENT OF TAXABLE PAYROLL² UNDER VARIOUS REAL EARNINGS ASSUMPTIONS,³ PRESENT LAW AND MODIFIED THEORETICAL SYSTEM⁴

[In percent]

System	Estimated under assumptions of— ³		
	5½-4	6-4	½-4
25-yr period:			
Present law	11.95	11.42	10.93
Modified theoretical	11.58	11.31	11.04
50-yr period:			
Present law	14.83	13.50	12.32
Modified theoretical	12.80	12.43	12.08
75-yr period:			
Present law	18.59	16.26	14.30
Modified theoretical	14.27	13.83	13.42

¹ "Average-current-cost" represents the arithmetic average of expenditures as percent of taxable payroll for the period and includes the cost of increasing the funds on hand to 1 yr expenditures by the end of the valuation period.

² Payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.

³ The initial value in each set refers to the assumed annual percent increases after 1930 in average earnings, while the 2d value in each set refers to the assumed percent increases after 1930 in CPI. Higher assumptions are used in the 1975-80 period.

⁴ See text for brief description of theoretical system.

As shown in appendix table F the average-current-cost of the old-age, survivors, and disability insurance system over a 75-year period is highly sensitive to changes in the assumed increases in average real earnings. For a modified theoretical system the sensitivity would be significantly reduced.

For the next 25-year period, that is, for the remainder of this century, the average-cost under present law would vary by about ½ percent of taxable payroll for every ½ percent change in annual increases in average real earnings. Under the modified theoretical system the changes in the 25-year average-cost would be equivalent to about ¼ percent of taxable payroll for each ½ percent change in annual increases in average real earnings. It should be observed that in all instances the average-cost over the next 25 years is higher than the tax rate in present law of 9.9 percent of taxable payroll that is scheduled for the period.

(8) SENSITIVITY TO DEMOGRAPHIC ASSUMPTIONS

This subparagraph contains a brief analysis of the sensitivity of the cost projections to changes in the demographic assumptions. The assumptions tested are those regarding the projected ultimate total fertility rates and the annual level of net migration. All other assumptions and all formulae and procedures remained the same as those used in the preparation of the cost estimates under the central set of economic assumptions.

Appendix table G shows the average-current-cost over periods of 25 years, 50 years, and 75 years under the central set of economic assumptions with three alternative assumptions of ultimate total fertility rates of 1.7 children per woman, 2.1 children per woman, and 2.5 children per woman. The table indicates the cost under the present law as well as under the modified theoretical system previously discussed.

APPENDIX TABLE G.—ESTIMATED LONG-RANGE AVERAGE-CURRENT COST¹ OF OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE SYSTEM AS PERCENT OF TAXABLE PAYROLL,² UNDER VARIOUS FERTILITY ASSUMPTIONS,³ PRESENT LAW AND MODIFIED THEORETICAL SYSTEM⁴

[In percent]			
System	Estimate under assumed fertility of— ⁵		
	1.7	2.1	2.5
25-yr period:			
Present law.....	11.40	11.42	11.43
Modified theoretical.....	11.28	11.31	11.32
50-yr period:			
Present law.....	13.80	13.50	13.23
Modified theoretical.....	12.68	12.43	12.21
75-yr period:			
Present law.....	17.72	16.26	15.19
Modified theoretical.....	14.95	13.83	13.00

¹ "Average-current-cost" represents the arithmetic average of expenditures as percent of taxable payroll for the period and includes the cost of increasing the funds on hand to one year's expenditures by the end of the valuation period.

² Payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.

³ These assumptions refer to the ultimate total fertility rate which is in terms of number of children per woman during her lifetime. In all cases the rate is assumed to start from its 1974 level and to move gradually to the ultimate level which would be attained by the year 2005.

⁴ See text for brief description of theoretical system.

⁵ Calculated under the central set of economic assumptions of annual increases after 1980 of 6 percent in average earnings and 4 percent in CPI. Higher assumptions are used in the 1975-80 period.

As shown in appendix table G the average-current-cost over a 75-year period of the old-age, survivors, and disability insurance system under either present law or the theoretical system is highly sensitive to changes in fertility assumptions.

Over the next 25 years the average-cost under either system would be slightly lower with assumed fertility and higher with higher assumed fertility, which is opposite to the effect over the 75-year period. This is due to the lower (or higher) survivor and dependent children benefits that would be payable during the 25-year period, which would not be offset by a lower (or higher) number of workers in the period.

It is clear from this table that for the next 25-year period regardless of future fertility the average-cost of the old-age, survivors, and disability insurance system will be significantly higher than the tax rate of 9.9 percent of taxable payroll scheduled in present law.

Appendix table H shows the average-cost over periods of 25 years, 50 years, and 75 years under three alternative assumptions of annual net migration of 300,000 persons, 400,000 persons, and 500,000 persons. The table indicates the cost under the present law as well as under the modified theoretical system previously discussed.

APPENDIX TABLE H.—ESTIMATED LONG-RANGE AVERAGE-CURRENT COST¹ OF OLD-AGE, SURVIVORS AND DISABILITY INSURANCE SYSTEM AS PERCENT OF TAXABLE PAYROLL,² UNDER VARIOUS MIGRATION ASSUMPTIONS:³ PRESENT LAW AND MODIFIED THEORETICAL SYSTEM⁴

[In percent]			
System	Estimated under assumed migration of— ⁵		
	300, 000	400, 000	500, 000
25-yr period:			
Present law.....	11.48	11.42	11.37
Modified theoretical.....	11.37	11.31	11.26
50-yr period:			
Present law.....	13.61	13.50	13.40
Modified theoretical.....	12.53	12.43	12.33
75-yr period:			
Present law.....	16.43	16.26	16.10
Modified theoretical.....	13.97	13.83	13.70

¹ "Average-current-cost" represents the arithmetic average of expenditures as percent of taxable payroll for the period and includes the cost of increasing the funds on hand to 1 yr's expenditures by the end of the valuation period.

² Payroll is adjusted to take into account the lower contribution rates on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.

³ These refer to the annual net migration which would be applicable to all future years. The distribution by age and sex of these immigrants is assumed to be identical to that in the preferred central set of assumptions.

⁴ See text for brief description of theoretical system.

⁵ Calculated under the central set of economic assumptions of annual increases after 1980 of 6 percent in average earnings and 4 percent in CPI. Higher assumptions are used in the 1975-80 period.

As shown in appendix table H the average-current-cost over all periods is relatively insensitive to changes in migration assumptions. This is the case under present law as well as under the modified theoretical system.

APPENDIX

APPENDIX B.—DETERMINATION AND ANNOUNCEMENT OF SOCIAL SECURITY CONTRIBUTION AND BENEFIT BASE AND RETIREMENT TEST EXEMPT AMOUNT FOR 1975 ¹

Pursuant to authority contained in sections 203(f) (8) and 230 of the Social Security Act (42 U.S.C. 403(f) (8) and 430), as amended by section 3(j) and (k) of Public Law 93-233, enacted December 31, 1973, I hereby determine and announce that the contribution and benefit base with respect to remuneration paid in, and taxable years beginning in 1975 shall be \$14,100 and the monthly exempt amount under the retirement test shall be \$210 with respect to taxable years ending in calendar year 1975.

There follows a statement of the actuarial bases employed in arriving at the amounts of \$210 and \$14,100 for the retirement test monthly exempt amount and the contribution and benefit base, respectively, for the calendar year 1975.

In determining each of the 1975 amounts, the law specifies a formula which automatically produces a mathematical result based upon reported statistics.

Section 203(f) (8) of the Act provides that the retirement test monthly exempt amount for 1975 shall be equal to the 1974 amount of \$200 multiplied by the ratio of (1) the average amount, per employee, of the taxable wages of all employees reported under the program for the first calendar quarter of 1974 to (2) the average amount of such wages reported for the first calendar quarter of 1973. The section further provides that if the amount so determined is not a multiple of \$10, it shall be rounded to the nearest multiple of \$10.

Similarly, section 230 of the Act provides that the contribution and benefit base for 1975 shall be equal to the 1974 amount of \$13,200 multiplied by the ratio of (1) the average amount, per employee, of the taxable wages of all employees reported under the program for the first calendar quarter of 1974 to (2) the average amount of such wages reported for the first calendar quarter of 1973. The section further provides that if the amount so determined is not a multiple of \$300, it shall be rounded to the nearest multiple of \$300.

The data used to make the necessary computations of such average taxable wages were derived from reports submitted to the Social Security Administration of taxable wages paid to employees by their employers. Each quarter, taxable wages are posted to the record of earnings of each individual employee for whom wages were reported. These records are referred to hereinafter as Summary Earnings Records. As the wages were posted to the Summary Earnings Records, the data were tabulated on a 100-percent basis to obtain the total amount of reported taxable wages and the total number of employees for whom such wages were reported.

Because of the requirement in the law that the foregoing determinations be made on or before November 1, 1974, the tabulated data on taxable wages reported for the first calendar quarter of 1974 were necessarily limited to those wages that were reported and posted to the Summary Earnings Records by the end of the quarterly updating operations completed in September 1974. In order that the required ratio referred to above be based on data reflecting comparable reporting and posting periods, the tabulated data on taxable wages reported for the first calendar quarter of 1973 were limited to those wages that were reported and posted to the Summary Earnings Records by the end of the quarterly updating operations completed in September 1973.

¹ This statement was published in the Federal Register for October 31, 1974 (Vol. 39, No. 211, pp. 38406-7).

About 70.6 million employees had taxable wages reported for the first calendar quarter of 1973 that were posted to the Summary Earnings Records by the end of September 1973, and the average amount of their taxable wages was \$1,895.04 per-employee. The corresponding number of employees and average amount of taxable wages for the first calendar quarter of 1974 were 71.1 million and \$2,007.69, respectively. The ratio of average taxable wages reported for the first quarter of 1974 to average taxable wages reported for the first quarter of 1973 is therefore 1.059445.

Multiplying the 1974 retirement test monthly exempt amount of \$200 by the ratio of 1.059445 produces the amount of \$211.89, which must then be rounded to \$210. Accordingly, the retirement test exempt amount for taxable years ending in calendar year 1975 is \$210 on a monthly basis, or \$2,520 on an annual basis.

Multiplying the 1974 contribution and benefit base of \$13,200 by the ratio of 1.059445 produces the amount of \$13,984.67, which must then be rounded to \$14,100. Accordingly, the contribution and benefit base for remuneration paid in, and taxable years beginning in, calendar year 1975 is \$14,100.

Dated: October 29, 1974.

CASPAR W. WEINBERGER,
Secretary.

Mr. BURKE. The subcommittee is adjourned.
[Whereupon, at 4:45 p.m., the subcommittee adjourned, to reconvene on Wednesday, May 14, 1975.]

FINANCING THE SOCIAL SECURITY SYSTEM

WEDNESDAY, MAY 14, 1975

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The subcommittee met at 1:10 p.m., pursuant to notice in room H-208, the Capitol, Hon. James A. Burke (chairman of the subcommittee) presiding.

Mr. BURKE. The subcommittee will be in order.

The purpose of today's hearing is to receive testimony from representatives of the latest Social Security Advisory Council.

The Social Security Act provides for the establishment of a new Social Security Advisory Council every 4 years in order to make known to the Congress the views of outstanding citizens representing the interests of workers, employers, and the general public, concerning the broad purposes of the social security system. Some of the most important changes in the law that have contributed to the development of the social security program have emanated from the individual advisory councils that have existed in the past. I am sure that the work of the latest advisory council will prove to offer important contributions to the development of solutions to the problems now facing the social security system.

I regret to announce that one of the panelists who was to have appeared today according to our original announcement, our close and esteemed former colleague, John W. Byrnes, is unable to be here for medical reasons, which I hope are not too serious, but which are unavoidable.

We have also had another last-minute cancellation, Dr. Arnold R. Weber, who is not able to appear today.

I now recognize Mr. W. Allen Wallis, chancellor of the University of Rochester, and also the chairman of the advisory council.

I understand that with you will be J. W. Van Gorkom, president, Trans Union Corp., Lincolnshire, Ill.; Rudolph Danstedt, assistant to the president, National Council of Senior Citizens; and J. Henry Smith, retired chairman of the board, Equitable Life Assurance Society of the United States.

You gentlemen may all join us at the table.

PANEL CONSISTING OF MEMBERS OF THE SOCIAL SECURITY ADVISORY COUNCIL: W. ALLEN WALLIS, CHAIRMAN (CHANCELLOR, UNIVERSITY OF ROCHESTER, N.Y.); J. W. VAN GORKOM, MEMBER (PRESIDENT, TRANS UNION CORP., LINCOLNSHIRE, ILL.); RUDOLPH DANSTEDT, MEMBER (ASSISTANT TO THE PRESIDENT, NATIONAL COUNCIL OF SENIOR CITIZENS); AND J. HENRY SMITH, MEMBER (RETIRED CHAIRMAN OF THE BOARD, EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES)

Mr. COTTER. Do we have all the testimony here? I have only three.

Mr. BURKE. Mr. Wallis, have you brought copies of your testimony with you?

Mr. WALLIS. I left them over at the main office. I am sorry. They did tell me to bring them over here.

Mr. BURKE. We will send for them; that's all right.

You are recognized, Mr. Wallis.

STATEMENT OF W. ALLEN WALLIS

Mr. WALLIS. Thank you, Mr. Chairman.

The 1974 Advisory Council on Social Security, of which I had the honor of being chairman, had only 8 months for its work instead of the usual 20 months or so. We, therefore, focused our attention on comparatively few topics. The most important of these were financial, the subject of today's session.

At our first meeting, on May 3 and 4, 1974, a Subcommittee on Financing was appointed. The chairman was Jerome W. Van Gorkom of Lake Forest, Ill., president of the Trans Union Corp. There were three other members: Rudolph T. Danstedt of Bethesda, Md., assistant to the President of the National Council of Senior Citizens; Elizabeth C. Norwood of Washington, D.C., assistant research director of the Eastern Conference of Teamsters; and J. Henry Smith of Maplewood, N.J., chairman of the board of the Equitable Life Assurance Society of the United States.

The Subcommittee on Finance had a panel of five actuarial and economic consultants. They were Phillip Cagan, professor of economics at Columbia University, New York, N.Y.; Martin Feldstein, professor of economics at Harvard University, Cambridge, Mass.; Robert J. Myers, professor of actuarial science at Temple University, Philadelphia, Pa.; Charles E. Trowbridge, senior vice president and chief actuary, the Bankers Life, Des Moines, Iowa; and Howard Young, consulting actuary and special consultant to the president of the United Auto Workers, Detroit, Mich. Mr. Myers and Mr. Trowbridge each was formerly Chief Actuary of the Social Security Administration.

I understood that Mr. Van Gorkom, Mr. Danstedt, and Mr. Smith are expected to present statements today. In addition, three of our consultants are expected to appear tomorrow, Mr. Feldstein, Mr. Myers, and Mr. Young. I will confine this statement to some general remarks.

Few people understand that social security is on a pay-as-you-go basis. Most people think that the taxes paid by them and their employers, for which the Government uses the euphemism "contributions," result in funds being accumulated to their individual accounts, from which their benefits eventually will be paid.

In fact, the so-called "contributions" are a special tax earmarked for certain specific governmental expenditures, in much the same way that the Federal tax on gasoline is earmarked for specific purposes.

Social security taxes when received by the Government are not set aside for the person who paid them nor credited to an account in his name. Instead, they are paid out immediately to someone who is already drawing benefits. Social security taxes are imposed for the benefit of those already on the rolls, not for the benefit of those who pay them. Correspondingly, when a person is drawing benefits, they are not a return of money he and his employer's paid in earlier but taxes collected for his benefit from those still working and their employers.

The fact that social security is on a pay-as-you-go basis is understood so widely and thoroughly here in Congress and at the Social Security headquarters in Baltimore, that it is not realized how widely and thoroughly it is misunderstood outside in the real world. Much confusion and concern about the future of social security would be dispelled if the public understood that the purpose of social security taxes is to provide benefits now to those who already have retired or otherwise qualified for benefits, and that the source of funds for benefits is taxation of those still working and their employers.

Once this is understood, it is clear that whether one will get his social security benefits when he qualifies is simply a question of whether enough taxes will be levied and collected at that time. The availability of funds to pay benefits has almost no relation to what was paid in or to the trust funds. The trust funds simply represent working balances needed because income and outgo are not equal day-by-day, week-by-week, month-by-month, or even year-by-year. How large the trust funds need to be depends on how great are the short-run imbalances between income and outgo, and how long it would take Congress to enact remedial legislation to correct a long-run imbalance.

Once the pay-as-you-go nature of the System is understood, it is easy to see that the short-run and long-run financial problems of social security are entirely different.

For the rest of this century, the main problem is that the present level of taxes is insufficient to cover the present level of benefits. An important part of the deficiency results from the method used to adjust benefits for inflation. The adjustment is made in a way that under current conditions will overadjust benefits as prices rise. This can be corrected in a straightforward way, which we recommend.

Beginning in the early part of the next century, the problem will be that there will be many more old people in proportion to people still working. Whereas there are now 30 people to be supported by each 100 working people, there will eventually be 45 to be supported by each 100. The "baby boom" of 1940-65 will result in a retirement boom from 2005 to 2030. The "birth dearth" since 1965 means that beginning about 1985 and lasting until at least 1995—and as much longer as the birth dearth continues after 1975—there will be a drop in the ratio of working people to retired people. Thus, if benefits are maintained, taxes will have to rise about 50 percent.

The Council recommended, as have previous councils, that social security benefits should continue to be related to earnings. It recommended a simplified and, I believe, generally improved formula for

relating benefits to earnings. This formula need not change the level of benefits.

The Council also recommended, again like earlier councils, that benefits should continue to be financed entirely from a tax on earnings rather than partly from general taxes. As with earlier councils, a minority dissented from this recommendation and favored the use of general taxes for part of the benefits.

In order to protect the principle of financing earnings-related benefits by earnings-related taxes, the Council recommended that some present benefits which are not related to earnings not be financed from payroll taxes. Of the several benefits that would be removed from payroll-tax financing under this recommendation, the most significant is medicare. The 1.8-percent payroll tax now collected for medicare would, if released for earnings-related social security benefits, be sufficient, after correcting the method of adjusting benefits for inflation, to balance income and outgo for some time to come.

The final point on which I wish to comment is the Council's recommendation that, as a foundation for the next council's work, there should be a comprehensive study by a non-Government body of such fundamental issues as full reserve funding versus current cost financing; the effects of social security on productivity, capital formation, and private savings; the relationship between private pensions and social security; the appropriate size of the trust funds; and other basic issues.

No council of this kind can carry out that type of research. Indeed, research is not properly a function of such a council. Instead, a council ought to be able to draw, to the extent that it finds appropriate, on a body of research relevant to the policy issues with which councils should deal.

Another reason for such a study is that the Social Security System has never so far as I know been subjected to a totally independent, detailed scrutiny of all of its actuarial, statistical, and technical assumptions and procedures. The trustees' reports and the reports of advisory councils have relied ultimately on the data and analyses of present or former members of the social security staff. No one else is competent enough, and the trustees and councils do not have enough time for completely fresh people to develop competence comparable with that of those who have had long experience with social security.

This is not to impugn in the slightest the competence, integrity, and dedication of the social security staff. On the contrary, the Council had the highest respect for, confidence in, and even admiration for the staff. But a review or audit needs to be independent, for truly independent reviews and audits have a value that simply cannot be attained without total independence.

The situation is in some ways like that with data on the Russian economy 20 years ago. There were numerous American experts working at different institutions and reaching generally consistent conclusions. The then-Chairman of the Council of Economic Advisors noticed, however, that all the experts had been trained alike and had been closely associated. He therefore arranged for a foundation grant to a private institution which had never studied the Russian economy, in order to bring in an outstanding economist who had never studied the Russian economy and to start from scratch to study the Russian economy. The resulting findings, while they took more time than

would have been needed by those already in the field, brought about important revisions in our understanding of the Russian economy.

In the next few years Congress and the public will focus more attention on social security than it has ever received before. It is important that completely independent evaluations and analyses be available, and this is by no stretch of the imagination a reflection on the present small group of social security experts. In addition, many basic issues should be studied that are outside the scope and competence of the Social Security Administration. The System is now 40 years old, and personally I attach great urgency to an independent, detailed, thorough, objective, nongovernmental review. Every effort should be made to have it completed in time for the 1978 Advisory Council to use its findings.

Thank you.

Mr. BURKE. Thank you, Mr. Wallis.

Now I believe what we should do is have all the members of the panel make their statements and then, after they complete their statements, the subcommittee will have questions.

We will now hear from J. W. Van Gorkom.

STATEMENT OF J. W. VAN GORKOM

Mr. VAN GORKOM. Well, I am not going to read my statement. I think you can do that in your spare time.

Mr. BURKE. Without objection, your entire statement will appear in the record.

You may summarize your position.

[The statement follows:]

STATEMENT OF J. W. VAN GORKOM

Social Security is divided into Medicare and Old Age Survivors and Disability Insurance (OASDI). I shall confine my remarks to OASDI.

One cannot really understand OASDI unless he realizes that it is only one part of a three-part system to replace wages lost by retirement, death or disability. The three parts are:

1. A fully contributory plan (OASDI).
2. Private means (individual savings and private pensions).
3. Noncontributory plans based on demonstrated need (an example is Supplemental Security Income).

All three are necessary if the job is to be done adequately, efficiently and with the least harm to the capital forming process in our country. Each has its special part to play.

The most important single criterion of a wage-replacement system is the "replacement ratio." This is simply the relationship between a worker's monthly benefit and the wage he earned just before he retired, died or was disabled. At present, OASDI produces replacement ratios ranging from about 60% for the lowest paid worker to about 30% for the highest paid worker.

Are these ratios adequate? Actually no definitive work has ever been done on that question for the simple reason that until now the basic philosophy has been "more is better," and this could very well have been true. Today the question is somewhat academic because the ratios are limited by the financial capacity of the system. Some argue strenuously that low-paid workers cannot absorb a further increase in the OASDI tax and this would then limit the benefits that can be paid. That is probably only a temporary problem for the low-paid worker, created by the recent phenomenon of price rises exceeding wage increases by a substantial margin.

The important fact is that the inability of OASDI to provide higher replacement ratios does not represent a failure of OASDI. That system is a fully contributory system and no such system can provide unlimited benefits. They must necessarily

be limited by the ability of the contributors to support the benefits. If higher amounts are required for some beneficiaries and the tax cannot be increased, the additional benefits should come from one of the other two parts of the system. That is exactly why they exist: to supplement the contributory part of the system.

Even at replacement ratios between 60% and 30%, OASDI will still provide adequate benefits for many millions of people. Other millions will have private means to supplement their Social Security benefits. If there are still others who require additional benefits for survival, then they can be provided from non-contributory plans. There is absolutely no reason to convert the contributory element (OASDI) into a noncontributory element by, for example, using general revenues in OASDI. It was realized from the beginning that OASDI could not do the job by itself, and that supplemental, noncontributory systems would have to exist alongside OASDI and private means as the three basic parts of the nation's support system.

With these preliminary background remarks, I should like to address myself to just four aspects of the system:

I—Modifying the benefit formula of OASDI so as to stabilize replacement ratios.

II—Basic causes of the financial deficit.

III—Financing the deficit from within the system.

IV—Financing the system by the use of general revenues.

I—MODIFYING THE BENEFIT FORMULA TO STABILIZE REPLACEMENT RATIOS

The Present OASDI system contains an unintended flaw which should be corrected as soon as possible. This flaw can cause replacement ratios to fluctuate widely, either up or down, depending on future movements of wages and prices. Since replacement ratios are an important criterion of a wage replacement system, uncontrolled changes therein are very undesirable. The Advisory Council made its strongest recommendation that the method of computing benefits be changed so as to eliminate this flaw. That recommendation is virtually uncontested and is as close to noncontroversial as any aspect of this subject can be.

The flaw and its proposed correction is described in detail in the Report of the Advisory Council on Social Security, beginning on page 129 and ending on page 135. It is not necessary to repeat that explanation here.

I would strongly urge Congress to adopt the proposed change as early as possible. The modification required is complex and there are several ways in which it can be accomplished. The Congress and its staff will have to work for several months with the Social Security Administration and perhaps with outside consultants in order to arrive at the best method for correcting the flaw, but the Advisory Council has done sufficient work with independent experts to assure itself that the task can be done. Most important, the correction can be approached in a completely nonpartisan way, because it is a technical correction that is in the best interests of everyone.

II—BASIC CAUSES OF THE FINANCIAL DEFICIT

The recently issued 1975 report of the Trustees of Social Security forecasts an average deficit of 5.3% over the next 75 years. This deficit occurs unevenly, being 1.26% for the first 25 years, 4.10% for the next 25 years and 10.19% for the last 25 years. Before discussing how this deficit can be covered, we need to understand the two basic reasons for this deficit, and they are described briefly below.

Until 1972 whenever Congress voted an increase in OASDI benefits, it usually voted an increase in the tax rate to cover the cost of the higher benefits. In 1972, Congress voted to increase benefits *automatically* whenever the price level rose by 3% or more. It did not, however, provide for automatic tax increases, although it did provide that the amount of wages subject to tax would also rise automatically each year in the same proportion as the average wages rose. For the 20 years prior to 1972, wages had risen at a compounded rate of about 4.5% whereas prices had risen at a compounded rate of 2.3%. Congress reasoned that as future price rises caused increases in the benefits, the accompanying wage increases, based on the traditional relationship between wages and prices, would cause sufficient increases in the tax collected to cover the higher benefits.

That reasoning was sound so long as wages rose about twice as fast as prices. In the past two years, however, the historical relationship between wages and

prices has been greatly distorted. Furthermore, it is now estimated that the ratio existing prior to 1972 will not return and that over the next 75 years wages will rise at a rate of 6% while prices rise at a 4% rate. With that kind of relationship between wages and prices, costs of the Social Security System will rise faster than its income, and this will result in a deficit of about 1.25% for the next 25 years. In other words, the increase in benefits due to 4% inflation will exceed the higher taxes resulting from the 6% wage rises and the higher maximum amounts of covered wages.

There are two factors which will actually tend to hold the deficit down during this first 25 years. One is the fact that the work force has been growing in recent years and will continue to grow for some years to come as the large group of "war babies" enter the work force and begin to contribute to the cost of the system in the form of Social Security taxes on their wages. There is also the fact that during the depression a smaller number of people were born than usual and there will be roughly a 10-year period during which the number of beneficiaries is growing at a lower than ordinary rate.

Adding substantially to the deficit after the year 2005 will be a change in the demography of the country. The total fertility rate rose rapidly after the war to a peak of 3.77 in the year 1957 and then declined gradually. This produced a bumper crop of "war babies" who will begin to draw retirement benefits after the year 2005. Since 1970, however, the birth rate has dropped precipitously and is now below the replacement rate of 2.1. It is expected to decline even further before returning gradually to the 2.1 level where it will level out. This means that there will be relatively few workers entering the work force after the year 2005, when the number of persons drawing benefits is growing rapidly. This will significantly change the ratio of workers to beneficiaries. Today there are 30 beneficiaries for every 100 workers, but by the year 2030 it is now estimated that there will be 50 beneficiaries for every 100 workers. This is bound to further increase the tax load on the workers and, added to the economic factors discussed above, will produce a very substantial deficit, estimated at 10.19% of covered wages, in the third 25-year period covered by the Trustees' report.

III—FINANCING THE DEFICIT FROM WITHIN THE SYSTEM

The deficit can be financed either from within the system or from outside by an infusion of general revenues. Each method requires analysis.

The most common method of financing from within is by an increase in the tax rate. The Advisory Council proposed a 1% tax increase and that would do the job for a decade or so, and a raise of 1.25% would cover us until the end of the century, based on current forecasts of the Trustees. (Only one-half of the increase would be borne by the worker, of course, and the other half by his employer.) This is the proper method and it is consistent with the basic principles of Social Security, viz.: That it be a system which is paid for by the beneficiaries and that benefits, therefore, be paid as a matter of right without having to establish need.

The basic objection to a tax increase arises from the fact that for some persons in the lowest wage brackets, the tax is becoming burdensome. It must be realized, however, that these are extraordinary times. In the past year wages have actually lagged behind price rises by a wide margin, thereby squeezing the worker. As this abnormal situation is corrected, however, the ability of the worker to pay the $\frac{1}{2}$ % increase in his tax should improve substantially. The long-term forecast projects a compounded annual growth in real wages (wage increases minus inflation) of 2% and that should permit even the low-paid worker to pay an additional $\frac{1}{2}$ % in his OASDI tax.

It has also been suggested that much of the short-term deficit be financed by raising the amount of wages subject to tax from \$14,100 per year to some arbitrarily higher amount. There is one major objection to such a plan, in that it would hinder the capital formation process in this country. Many persons who make over \$14,100 per year can be expected to save a part of the excess. To the extent that this excess is made subject to OASDI taxes, it will reduce the amount available for saving and thereby impede the formation of capital at a time when it is critically needed. Mr. Martin Feldstein, of Harvard, has developed this point at great length and will testify before you tomorrow.

It is recognized that the \$14,100 is, itself, an arbitrary amount and that it is estimated to rise automatically under the present law to \$19,000 by 1979. This increase, however, will be gradual and will be largely absorbed by increases in prices forecast for that same period, meaning that the \$19,000 will stand in the same position in 1979 that the \$14,100 does today, insofar as *savings* is concerned.

The best that can be said for the idea of arbitrarily raising the maximum covered wage now is that it is better than an infusion of general revenues.

There is one other thought that should be kept in mind. Today the work force is growing constantly as the "war babies" move into the labor market. This has led to heavy pressure to reduce the retirement age so as to "make room" for the new workers. Obviously, any such reduction would substantially increase the deficit and exacerbate the serious financial problem already faced by OASDI. These pressures must be resisted.

Furthermore, when examining the *long-term* deficit, we must realize that after the year 2005 the current trends will be reversed. Then the number of persons retiring will exceed those entering the work force and this will create a very large part of the future deficit by increasing the number of beneficiaries to the number of workers. The tax rate required by 2030 will be 50% to 100% higher than it is today and the problem far more severe.

At that time and under those circumstances, the Congress should certainly be willing to consider a modest increase in the retirement age to 67 or 68. While such an increase may be unthinkable today, economic and demographic factors may make it mandatory then. Another 40 years of improved health care and longevity will also be moving in the same direction.

IV—FINANCING THE SYSTEM BY THE USE OF GENERAL REVENUES

The most controversial proposal for financing OASDI involves the use of general revenues. A majority of the Advisory Council voted against any such action and I joined with that majority. My primary objection is based on the fact that such action is unnecessary to the goal that its proponents seek to attain. Alternatives are easily available that would not require such a fundamental modification of OASDI.

Social Security is only one part of the wage replacement system. It cannot do the entire job itself nor did the Congress ever expect it to do so. From the very beginning there were *three elements* to the program. It is important to understand all three if one is to understand why an infusion of general funds into the Social Security system is both undesirable and completely unnecessary to the goal we seek.

Social Security, the first element in the system, has certain important characteristics. It provides benefits based on wages and it requires the beneficiaries to pay for such benefits by a tax on wages. It is a *contributory* plan. This means that benefits are received as a matter of right, because they are "paid for." The worker does not have to prove need to receive his benefits. True, the benefits are not exactly related to wages because society has seen fit to weight the benefits in certain ways so as to accomplish specific social goals. But the relationship is real enough to produce a sense of responsibility for the success of the system on the part of the workers who pay the taxes that sustain it, and this is an important factor in its strength and survival.

The second element in the system is "private means." This refers to individual savings which are invested in stocks, bonds, savings accounts, etc. It also includes private pensions which have grown enormously in recent years. These private means supplement OASDI and are very important to the nation, because they provide the invested capital that fuels the economy. We all know that adequate capital formation is a major concern of the country today.

But even OASDI and private means are not sufficient to provide adequate benefits for all persons. The third element in the system is composed of programs measured by need. These are noncontributory plans. An excellent example of this element is the Supplemental Security Income program, which is funded from general revenues and which guarantees a minimum of \$144 to every individual over 65 and \$216 to any couple over 65. If it is deemed necessary to infuse general revenues into the system, then they should be used in this third part of the system and not within the Social Security system.

If general revenues are pumped into the Social Security system it will tend to destroy the relationship between the wages of the worker and his benefits. It will distort the relationship between the taxes he pays and the benefits he receives. It will diminish the contributory nature of the system. This will cause him to lose the sense of responsibility for the system which he now feels.

It is also true that if general revenues are employed within OASDI, it will eventually lead to a needs test for benefits, and this would undermine another important characteristic of the system. To understand this point it is necessary to analyze why general revenues are sought and how they would be used.

Normally any increase in OASDI benefits would be funded by an increase in the tax rate. Most of the current workers can pay the increase, but some of the lowest paid workers are finding the tax a burden at this particular time. On the other side, many workers receive an adequate benefit from OASDI, and others are able to supplement their benefits with private means. There is a small group, however, who do not receive an adequate benefit and who have insufficient private means. In order to help these persons and avoid a tax increase, it has been urged that general revenues be employed.

But how do you use such general revenues within the Social Security system? There are three possible methods:

First, we can use the general revenues to increase the benefits of all participants in OASDI. This means, however, that even those workers who are already receiving adequate benefits will now receive additional benefits. It also results in the maximum cost because it covers everyone in the system. Since our goal is just to help those whose benefits are inadequate, this is not a sound approach.

The next alternative is to increase only the minimum benefit so as to help those at the end of the economic scale. This would be sound were it not for the fact that there are large numbers of persons drawing minimum benefits who are also receiving substantial pensions from work not covered by OASDI. An example is the person who has worked for the government for 30 years and has earned a large pension, and who then works in another job that is covered by OASDI for just the short period necessary to qualify for the minimum benefit. This is not an isolated example; it is a widespread tactic, deliberately employed. A study in 1968 established that over 40% of persons receiving government pensions also received some OASDI benefits, and that percent has probably risen since then.

There are also persons drawing minimum benefits who have substantial private means. They have been only sporadically in the work force and their minimum benefit reflects that fact; it does not mean they are economically deprived. Raising the minimum benefit would also help them, when such help is not our goal.

The third alternative is to use general funds in OASDI but only for those persons who can demonstrate a need for such assistance. In this way the funds can be directed to the persons who really need help. Only this method will confine the aid to the needy and avoid windfall benefits to those who are not. Only this method will attain the goal at minimum cost.

But this requires the use of a needs test, and a needs test is contrary to the basic concept of OASDI. If introduced, it will convert the contributory system to a noncontributory system. It will destroy one of the most important and desirable characteristics of OASDI: payment of benefits as a matter of right. Even this would be acceptable if there were no other way to accomplish the objective. But there is another way, and it is consistent with the total program. We should simply provide such general revenues through a needs-tested program outside of the OASDI system. Some such programs already exist and they could be expanded or new ones created. Why make a basic change in the OASDI system when such a simple alternative is readily available? My proposal would accomplish the goal at minimum cost, would avoid windfall benefits to the underserving and would leave the OASDI system unimpaired to do its own special job and make its own special contribution to the total system of wage replacement.

Mr. VAN GORKOM. We are going to make this as meaningful as possible for members of the committee here, and I think, therefore, answer any questions you have.

I would like to make a few comments with regard to the financing.

The report of the Advisory Council contains a report of the Subcommittee on Finance, which starts at page 113. For those of you who are not thoroughly familiar with the financing of Social Security, I would recommend that you take the time to read it.

We have gone into great detail to explain for the first time how the system really works. Those of us in the Council for the first time were surprised to learn some of the things that make up Social Security, particularly the retirement and disability benefits and how it works, and were also appalled at the fact that the public is so grossly misinformed, as Mr. Wallis has said.

We think a system this important to the general public, with over 90 percent of the workers involved covered, and over 31 million beneficiaries, ought to be clearly understood by the public. Many of them worry needlessly about it, as Mr. Wallis has said, because they don't understand it.

So we have taken the trouble this time in the Advisory Council's report on financing to not only come to grips with the problems, or attempt to do so, but also to give some preliminary explanations so we have in one place a clear and fairly lucid, I think, explanation of how the system works.

We would hope that it gets more publicity than some rather wild statements by certain members of the media.

Social Security, of course, is composed of both Medicare and what we call OASDI, the Old Age Survivors and Disability Insurance. To most people that is what Social Security is, the Retirement and Disability program, and that is what I am going to be emphasizing.

The only recommendation made by the Council with regard to Medicare was that Medicare should be financed by general revenues, and I will talk a little bit about that at the end, but primarily now I would like to talk about the retirement and disability aspects of it.

I think it is important to understand certainly one basic fact about the OASDI system, and that is it was never intended to do the entire job of providing wage replacement for the retired and the disabled. From the very beginning it was intended to be one part of a 3-tier system, and a most important part, OASDI—it was the contributory aspect of the plan.

The second part, of course, was private means. That is not only private savings that are invested in stocks, bonds, and so forth, but also private pensions which have become very important, and this has become an important aspect.

Lastly, the third tier is what we call needs tested systems, sometimes loosely referred to as welfare, but they were programs to support those at the very bottom of the scale who didn't have either enough from OASDI or private means.

Now, all three of those are very important to the total plan of providing a retirement wage, and help to the disabled. They each have their own different job to do, and the system would not be whole and complete, it would be less efficient, it would be crippled if any one of them were eliminated or reduced in importance.

The first and most important recommendation that the Advisory Council made was to make a rather basic change in the benefit formula.

It's a complex subject, and I am not going to go into it at length, except as long as you wish to and in as much detail after the basic presentation has been made. But it was the one recommendation I think that was unanimous and to which there is no objection, so far as I know. There is a flaw in the system at the present time, a flaw that was not intended and which did not readily appear until the introduction of the automatic benefit increases of 1972 and the sharp changes made in the relationship between wages and prices.

This flaw causes benefit replacement ratios to fluctuate. A replacement ratio is a good index of how well a system of this type works. It is the relationship between a retired or disabled person's monthly benefit to his wage just before he retired or was disabled.

Now, the replacement ratio is an important criterion of a system like this, and it should be stable. The Council takes no position as to what that ratio should be, but whatever ratio is selected by Congress, it should be stable over the years.

Under the present system the ratios can vary very widely, they can double or they can be cut in half, depending on what happens to wages and prices, factors over which neither the Congress nor anyone else has much control. So it was the unanimous recommendation of the Council that this flaw be eliminated. It can be done in such a way as to not reduce anybody's current benefits, and it can be done in any one of several ways.

Therefore, Congress will have to have the advice of the people in the Social Security Administration, and also, if they wish, outside consultants.

The Subcommittee on Finance had the advice of five economists and actuaries, two of the actuaries having spent a good part of their life in the Social Security System.

They have all concluded that this can be done without hardship to anybody, and that it should be done in order to make the system better. It is noncontroversial, and I would strongly recommend it.

Now, as you are well aware, the trustees of the Social Security System, OASDI, have just put out their annual report in which they estimate a long-term 75-year deficit which would average 5.3 percent.

I think it is worthwhile to take just a minute or two to explain why such a deficit occurs. It was customary on the part of the Congress for many years to increase the benefits from time to time to keep pace with inflation and for other reasons, and usually when they did they would also increase the taxes.

In 1972 the law took a sharp change in the sense that Congress decided that thereafter the benefits would go up automatically. At the time that that law was passed, they did not introduce an automatic tax increase, and for a very good reason. For 20 years prior to that time the wages had been rising on an average about twice as fast as prices. With that kind of relationship between wages and prices, it wasn't necessary to increase the tax, because, as the cost of living increased the benefits, the increased wages that naturally followed would create the larger amount of tax revenue to support the higher benefits.

But what has happened, very simply, since then, as you all know, is that this historical relationship between wages and price increases has been blown out of the water. It has changed very drastically.

Now, of course, over the life of the Social Security System, generally figured in 75-year increments, what happens for a couple of years isn't significant. But there are certain factors in the world today and in our economy which have led the economists who advise Social Security to assume, and this was also confirmed by other bodies, that the long-term projection of wages and prices will be 6-percent increase in wages and 4-percent increase in prices.

If that continues over the 75-year period on an average, the cost will consistently outrun the income. Not by any horrendous amount so that the system is going to collapse immediately, but it will mean an increase in the tax rate in order to maintain the integrity of the system.

Now, that deficit is only estimated to be $1\frac{1}{4}$ percent for the next 25 years, not a very big amount. And it coincides closely with the recommendation of the Council that the tax rate be increased now by 1 percent.

After you get beyond the year 2005 another element enters, and that is one to which Mr. Wallis has already referred, and that is the demographic change. After 2005 the relationship between the number of workers and the number of people drawing benefits changes quite drastically for a system of this type, and that greatly increases the cost, so that when you get out 50 years from now the estimated deficit will be 10 percent for the last 25 years.

To put these in context, when we say a 10-percent deficit, we mean 10 percent of the total wages covered by the Social Security System, and today that figure is just over \$600 billion. So a 10-percent deficit is \$60 billion per year.

At today's rates, given the inflation and wage increases forecasted by the Social Security System and others, the increase in the third 25-year period would be over \$400 billion per year. So it's a significant amount, caused by the demographic and economic forecasts.

To finance the deficit, the Council looked at a variety of things. There are two ways to finance it, from within the system and from without.

Let's talk, of course, just briefly about financing it from within the system, the most obvious one being an increase in tax rate.

The Council recommended an increase of 1 percent of the tax rate. That on the basis of present projections would be enough to carry the present system and maintain its integrity for at least 10 years.

If it was set at $1\frac{1}{4}$ percent, that would carry it 25 years, on the basis of current estimates.

There has been, of course, a good deal of publicity on the fact that people in the lowest wage brackets are having difficulty paying the social security tax, because for some of them it has become a bigger burden than the income tax.

It's fair to say, however, that this is a temporary problem, the reason being, of course, that for the last 12 months or so prices have actually outrun wages, which is a very unusual thing, although it occurs from time to time in the business cycle. But on a long-term basis it is estimated that real wages, that is wage increases minus the inflation rate, will average 2 percent increase per year, on a compounded annual basis.

With that kind of a forecast, of course, on any long-term basis it's quite feasible for even the low-paid worker to increase his wage tax by one-half of 1 percent. Because, you see, the 1 percent increase recommended by the Council is borne 50-50, 50 percent by the worker and 50 percent by the employer. So that's only a one-half percent increase for the worker.

So it's our opinion, it's the opinion of the majority, I should say, of the Council, that the increase in the tax is a double thing; it's not an unreasonable long-term burden on the low-paid individual, although it may be for a short period.

Another concept considered by the Council and for a time accepted and later rejected was the raising of the maximum amount subject to social security tax. At the present time that stands at \$14,100.

Wages beyond that point are not subject to the tax, and of course no benefits accrue for those wages. It has been suggested by a large number of people from varying groups to increase that arbitrarily to \$24,000, \$30,000, unlimited numbers.

It has also been recommended that perhaps that should be paid only by the employer, not the employee; variations of this concept have been proposed.

The majority, again, of the Council rejected this concept for one very basic reason. To increase the maximum amount subject to tax would interfere with or reduce capital formation in this country. The reasoning is very simple. People who make above \$14,000 per year can be expected to save some portion of the amount above 14,000, that is, a large number of them will save some part of it. If a part of it is taken from them in social security tax, they will not save that amount, and thereby the total capital foundation of the country will be reduced.

Professor Feldstein from Harvard is going to talk to you tomorrow on this whole subject of capital formation. He submitted a paper to you, and he will go into greater detail, so I will not.

I will have to say, first, I am not qualified; and it's a highly complex subject, not thoroughly understood even by economists, except they do agree, many of them, that increases in the social security tax do reduce capital formation in the country.

The Council also recommended that the Congress consider at some time down the road starting in the next century increasing the retirement age.

Today such a concept, of course, is unthinkable, because today we have the working force being increased constantly and therefore really a lot of pressure being brought to bear to reduce the retirement age. But you must realize that in the beginning of the next century this phenomenon will reverse itself, and the wage force, working force, will be going down, and the number of beneficiaries in relation to the workers will be going up, and therefore a modest increase in retirement age would help balance the budget at that time if it's needed.

Now, probably the most controversial item with regard to financing of social security, and particularly the OASDI system, is the recommendation that general revenues be introduced, that is, that the system no longer be financed by simply a tax on wages.

The majority of the Council opposed this recommendation, and a minority supported it. The arguments are not readily apparent, but basically they stem from this analysis. As I said earlier, social security is a 3-tier system, and one part of it is OASDI.

The OASDI system has certain basic characteristics that have served it very well and have been responsible for its strength and survival over the years. One is of course that it is contributory; the costs of this system are paid by the workers.

Now, the payment by the worker and what he gets out of it are not directly related, because the benefits, as you probably know, are weighted in favor of the low-paid employee for social reasons. But there is enough of a relationship so that the worker today realizes that he is paying for his social security benefits, and those benefits then are received as a matter of right, they are not a question of demonstrated need. They are received as a matter of right, and that is also a very

important element. It has made the worker feel responsible for the maintenance and support of this system.

The second part is, of course, private resources. This second part of the total plan for wage replacement is very important to this country, because that is the main source of capital formation in this country. We do not want to discourage people from saving money for their retirement or for other reasons. This has been a very important part of the total support system after retirement or disability.

It was recognized, of course, and it is today that some people will not get enough from the OASDI system, nor will they get enough from private means, because in some instances they have little or none, and therefore there has always been this third tier, the "needs tested" programs.

The most important example is the supplementary security income plan, which says in essence anybody over 65 who doesn't get at least \$142, I believe it is, per month, will get it from the SSI program. In other words, if OASDI and private means are not adequate to meet a particular individual's needs, we will have to have another system over here side by side.

Now, the argument of the majority of the Council is very simple: If there are people who need additional amounts for support in old age and under disability circumstances, and if that support cannot be obtained by increasing the tax rates of the social security system, and general revenues are required, very well, use general revenues, but use them through the needs tested programs.

There is no need to change the contributory part of the total plan, OASDI, and turn it into at least a partially noncontributory plan, when we already have a mechanism in existence to handle this problem.

There is another basic reason, and that is if general revenues are introduced into the OASDI, into the social security system, it will eventually lead to a needs test in social security. Today it isn't; you get your social security benefits as a matter of right, regardless of what your income or circumstances are. If you introduce general revenues, you will eventually have a needs test in social security.

The reason is not readily apparent, but what you have to say is why do we want to introduce general revenues? Well, the answer I think is fairly clear: because we know that there are some people in our society who do not get enough from social security and who do not have enough of private means, and therefore we want to help them. Secondly, we know that there is some objection to increasing the tax rate.

Well, if you take general revenues in the social security, how will you use them? There are only three ways to do it.

One, you can say we will increase the total benefits structure so that everybody gets more, and that will raise the people at the bottom to the point where they get enough.

That is obviously the most expensive way to do it, because it means raising the benefits structure for everybody and it means a large amount of general revenues have to be infused. It also means, of course, that people who already have adequate benefits will get additional benefits.

Probably the better way would be, let's increase the minimum benefit, then everybody will get at least a minimum, and the general revenues can be used for that.

The problem that the Council found with that was something that none of us had realized until we got on the Council, and that is there are many, many people who draw minimum benefits under social security who are not economically deprived in any sense of the word.

One of the most common examples is the very large number of Government employees, not only Federal, but State and local as well, who work under governmental systems that are not covered by social security for 25 or 30 years and earn a very adequate pension, and then leave or moonlight and work for a short period of time to obtain the benefit of a minimum pension offered by social security.

A survey made as long ago as 1968 indicates that over 40 percent of Government employees who were receiving Government pensions also receive benefits under social security. This is not an isolated incident.

It also means that there are a number of people drawing minimum benefits under social security who have private means. The reason they have minimum benefits is not because they worked in low-paid jobs but because they have only worked sporadically.

All of this gets back to the fact if you are going to infuse general revenues into social security, the only way to do it as cheaply as possible and help the people you really want to help is to have a needs test; say we will give additional social security benefits to those people who cannot get enough out of their benefits structure or have private means.

But if you introduce a needs test you will have basically altered the OASDI system, which has always been based on a right to receive benefits rather than on demonstrated need. For that reason, since we already have other structures in existence which are based on need and which can be used to answer the very problem that is raised by those who seek general revenues, we don't see any reason to change the contributory aspect of the system.

I have probably talked too long, I'm sorry.

Mr. BURKE. Thank you very much.

We will now hear from Mr. Danstedt.

STATEMENT OF RUDOLPH T. DANSTEDT

Mr. DANSTEDT. Mr. Chairman, I was just thinking as we are talking here that I have appeared before the Ways and Means Committee many times in Washington, and I am not too happy about it that I am not talking about increased benefits at some point, but in a sense trying to defend what we have and trying to find some way to improve it.

You will notice if you look at my material, and I sent it in, and I am going to talk to it but I don't want to read from it.

Mr. BURKE. Without objection, your entire statement will appear in the record.

Mr. DANSTEDT. Thank you.

[The statement follows:]

STATEMENT OF RUDOLPH T. DANSTEDT

Mr. Chairman and members of the committee, I am Rudolph T. Danstedt, Assistant to the President of the National Council of Senior Citizens and a public member of the 1974-75 Advisory Council on Social Security.

I was the only member of the Advisory Council to file not only a Supplementary Statement, but a Dissent to the action taken by the majority of the Council to finance the deficit in the cash benefits side of the Social Security program from the contributions made for hospital insurance, and to substitute for these funds payments from the general revenues. I also objected to the circumstances under which and the haste with which the majority of the Council proposed what I hold is a destructive action.

We actually didn't get down to considering what we ought to do about the cash benefits deficit over the next twenty-five years until the next to the last session, where the majority approved a raise in the wage base to \$24,000, but then, at the last session this earlier action was rejected, and, on the evening of the last day, at what amounted to a "buzz" session—not an official meeting of the Council—and in what was a sort of fiscal shell game—the pea was found under the hospital insurance shell.

It was argued that contributions to hospital insurance are not wage related and that benefits bear no relation to the contributions made. Therefore it was held that there is no real reason for funding such costs by a tax on wages. Hospital expenditures, it was claimed, would seem to be more properly funded by the general revenues. Under the pressure of time, this proposal to use the hospital insurance contributions to finance the deficit on the cash side of the program was approved by the majority.

It hardly needs to be argued with the knowledgeable members of this Committee that the hospital insurance program is just as much social insurance as the cash benefit program. Payroll contributions to hospital insurance constitute a contract between the worker and his government that when he retires and/or is disabled, his income falls and the incidence of illness rises, his costs of hospital care will be substantially provided for. Financing hospital insurance exclusively from the general revenues destroys the right to such hospital insurance payments, opens the door to the application of a means test and equates the program with Medicaid.

The Council's proposal to use the general revenues for financing the hospital program got promptly vetoed by the Administration. When the Report was scheduled to be presented to HEW Secretary Weinberger on Friday, March 7, 1975, although the Secretary was not present, his presence was felt in the press statement he issued which read in part:

"The only recommendation of the Advisory Council I must oppose now is the one which calls for the introduction of substantial amounts of general revenue financing into the social security system. I think such a step would be inappropriate for a program whose strength has depended so heavily on support by working people and their employers. We should find other ways to solve the financing problems in social security."

Later on the same day a statement by the President indicated that such a shift (i.e., the use of general revenue funds for financing hospital insurance) would depart from the "earned right principle" that he strongly supports as a basic feature of social security.

Social Security was in the news when the Advisory Council began its deliberations and now again, about two months after we have concluded our activities, is in the news again with the Report of the Social Security Trustees, which projects a long-term deficit in the Social Security system of 5.3%—in contrast to the projection made in the previous report of the Board of Trustees of 3%.

As other witnesses have testified, we were all concerned on the Advisory Council about the impact double-digit inflation is having on the cost of the Social Security system and the unintended effect of the 1972 Cost of Living formula, which my organization, the National Council of Senior Citizens, supported. In my Supplementary Statement and Dissent, I supported the Council's recommendation, which has been outlined in substantial detail by the previous witnesses, that the method of computing social security benefits be changed to a system guaranteeing that the protection for current workers is kept up to date automatically at least as high as future increases in the level of earnings and that, as in the present system benefits once payable would be kept up to date with increases in prices. I support this recommendation, however, with the understanding that the "wage replacement ratios" established under the new system will be those pertaining under present law after the updating of benefits in June of 1975.

I made a series of proposals in my Supplementary Statement and Dissent, that against the fertility, wage and cost of living assumptions then available to us, are, in my judgment, realistic, solid and fiscally responsible. I am pleased that these recommendations have in general outline, found the approval of both the AFL-CIO and the UAW—representatives of a substantial section of the workers who are called upon to pay social security taxes.

I have reviewed the projections of the Trustees with respect to the funding status of the social security system and the kinds of recommendations the Administration appears to be considering with respect to meeting short-term financing problems, and find no reason for fundamentally changing the recommendations that I presented—except that there seems a good probability that we may have to move into general revenue financing somewhat sooner in this century than the earlier set of assumptions would have required. With the introductory caveat that I object to any increase in the payroll tax, the following are recommendations that I presented in my Supplementary Statement and Dissent:

1. Beginning in calendar year 1977 the maximum amount counted for the computation of benefits and for contributions—the wage base—should be raised above the approximately \$16,800 that can be expected to be in effect in 1977 under present law. The economic impact of such an increase would not be felt until the fall of 1977 because it is not until then that any significant number of workers would have earnings that exceed the \$16,800 figure that would be in effect in any event. The exact amount of the increase in the earnings base should be determined by whether it is to be done in one step or in several steps. One alternative is to increase the amount to \$24,000 in 1977 and have it rise automatically from this figure as wages increase. Another possibility is to provide for more gradual increases, that is, a lesser increase for 1977, compensated for by larger increases later. It is of interest to note that the AFL-CIO Executive Council has endorsed moving the wage base up to \$28,000 over a period of years.

2. A tax on the employer's full payroll. A maximum on the benefit and contribution base for individual workers is appropriate since the amount that people pay and the amount that is credited to their record for benefit purposes should be tied together, and it would seem unreasonable under social insurance to compute benefits on the very high salaries earned by the top 2% or 3% of the wage-earning portion of the population. There is no similar need for a limitation on employer's payroll. The tax on employer's payroll is less now than contemplated in the original Social Security Act. There was then provided an ultimate combined employer tax rate for social security and unemployment compensation totalling 6%. Because of the lower proportion of wages now covered under the experience rating of unemployment compensation and the increased tax deductible advantages now available through corporate tax laws, the tax burden on employers is now significantly less than provided by the original law.

3. That since the hospital insurance program, because of the rise in the wage base, will be over financed, the 1978 scheduled increase of 0.2% of payroll to employees and the like amount on employers, be allocated to the cash benefit program.

4. That there be restored to the Social Security law the provision for general revenue financing that existed from 1944-50 which reads: "There is also authorized to be appropriated sums as may be required to finance the benefits and payments provided for in this title."

These first three recommendations, according to the best estimates I have been able to obtain, will solve the short-run financing problem of the cash benefit program and carry the cash benefit program on a self-sufficient basis well into 1980's. Then, depending on what happens to the wage and cost of living rates, a limited contribution may be required from the general revenues in the last decade of this century.

Finally, with respect to the twenty-first century, my statement sees no need to provide, on the basis of a highly speculative set of assumptions concerning the movement of wages and prices, a set of contribution rates in the next century that are any higher than those required to support the program over the next few decades, and have recommended that it would be more reasonable now to provide specifically for contribution income to finance the present program over such a period, and at the same time to restore to the social security law the provision for general revenue financing that was contained in the law from 1944 to 1950.

My statement further holds that the predicted change in the age composition of the population does not present any major increase in the burden of supporting non-workers. The very assumptions that lead to an increasing proportion of older people to those of working age leads to a smaller number of children per person of

working age. Taking the two non-working parts of the population together—the retired aged and children—there is little change in the ratio of dependents to workers. Thus the resources now required for the upbringing and education of children can under these population assumptions be directed toward providing for older people, at least in part, without any increased burden on current workers. Under such circumstances there is little doubt also but that labor force participation of older people would increase. Cost savings to social security would, of course, result from such increased labor force participation by older people. It is not necessary to change the legal age at which an individual becomes eligible for benefits, as discussed in the Council. With greater opportunity for employment, the cost savings will come about automatically. The proposal to change the legal age of entitlement not only violates the agreement between the social security payee and his government, but penalizes the person who chooses to retire or has to retire because of health or employment circumstances.

It is also possible that costs in the next century measured as a percentage of covered payroll will be smaller than indicated by current estimates because of greater labor force participation by women. With smaller families such a result would seem to be quite likely. Most fundamental, of course, is the long-range trend of productivity increases. Although as indicated earlier, the long-range actuarial deficit of the system is 3% of payroll with an assumption of 5% increases in wages and 3% increases in prices and a 6% of payroll deficit on a long-range assumption of a 6% increase in wages and a 4% increase in prices, an assumption of a 5% increase in wages and a 2% increase in prices shows the present program to be fully financed! Thus, whether or not there really is a long-range financing problem for social security depends on a highly speculative set of assumptions about fertility rates, labor force participation rates, and long-range movement of wages and prices and the productivity of the labor force.

However, I have come out of this experience of serving on this Citizens Board of Review subscribing fully to the conviction contained in the title of the recently issued White Paper, endorsed by five former HEW Secretaries and three former Social Security Commissioners, "Social Security: A Sound and Durable Institution of Great Value." I agree fully with the authors of this White Paper that (1) the short-term financial problems of the Social Security system are clearly manageable without radical change, and (2) any long-range problems in the financing of social security can and will be met in a way to fully redeem the promises made to social security contributors.

Mr. DANSTEDT. I was the only member to file a dissent, and I dissented for two reasons.

I found I first objected very strongly to the proposal of the majority to use the hospital insurance funds to fund a deficit in the OSADI System. I would use exactly the same argument Mr. Van Gorkom has, if you begin financing social security under general revenues it isn't going to be long before it becomes a medicaid system and subjected to some kind of means test.

When I paid over the years my medicare tax and I did this under the assumption that I had a right to medicare without any needs test of any sort. I think it is just as much a right as is true also of the tax that is paid for the cash benefits. In other words, I don't differentiate between the tax you pay for OASDI and the tax you pay for hospital insurance; you are paying against the assumption in your latter days when you become 65 years of age and your income is down and your health conditions are worse, that you are going to be taken care of substantially by the medicare program.

Second, I filed a dissent because, although I enjoyed the opportunity of working with this very unusual group of the Advisory Council, I felt we kind of lost our grip a little bit in the last few sessions. I think we were against a time pressure and we began operating too hastily and without due consideration of all the matters.

At one point we were for a \$24,000 a year wage base. Now, some of us wanted that not to be financed by an increase in taxes, but then by

the time we came around to the next meeting that had been washed out and we really didn't have any financial proposals at that particular point.

So there was a little informal session of the group in the evening—it was not a formal meeting of the Advisory Council—and we played a kind of a shell game. We looked at the different shells, picked up a pea and found hospital insurance and decided that would be the method to finance the deficit in the cash side of the system.

As I indicated before, I think this is going to lead us down the track, if we move in this direction, towards some kind of a medicaid system.

And I got some encouragement also when the council reported on March 7, by the fact that both the Secretary of HEW Mr. Weinberger and the President objected also to use of the general revenues for financing medicare; not with the same reasons I did, but they object generally to the use of the general revenues. So I felt in a sense I was justified at that point in having taken this position.

However, I also felt very strongly that as a dissenter I had an obligation to come up with an alternative program of some sort. I am free to confess I have gotten a lot of help on this. I consulted left and right with the social security authorities and got their wisdom with respect to this.

If we establish the caveat first that we don't want any increase in the taxes, what can we then do to meet the short-range deficit, which I recall under our estimates at the time was 1 percent, and now the short-range deficit I think under the new report of the trustees is on the order of 2 percent, and the long-range deficit in the previous projection of 3 percent we now find is 5.3 percent—what can we do to deal with that both in the short range as well as in the long range?

So I certainly went along with the decoupling proposal, and as a matter of fact we had unanimous endorsement by the Advisory Council to which Mr. Van Gorkom so ably addressed himself, and I for one certainly hope we move in that direction.

I don't know what it is going to mean in terms of the new report of the trustees, but I think it is on the order of 2 percent, something like that.

I felt, however, after having done that, there were a number of other steps we have to take. I have evaluated this as far as I have been able to do in relationship to the new trustees' report, and I think the recommendations which I have made are still essentially valid, although some of the time schedules might have to be moved ahead a little bit.

I recommended that we increase the wage base first to \$24,000; then gradually move it up to \$28,000. Then I was rather pleased to discover the AFL-CIO Executive Council had made about the same decision in February after we had completed our report.

Now, this I know, this concern expressed about what this is going to do to savings and capital formation and all the rest of the sort of thing, I can say one thing: I wish during my working life that my whole salary had been taxed for social security; I would have a better social security payment than I have now.

So if you move some guy up to \$24,000 or \$28,000 he is going to have a much better social security payment than he would get just letting the thing escalate along with the rise of the cost of living.

So I don't get too concerned about this is going to somehow interfere with capital formation, and someone who has never earned any big money but comfortable living—I never accumulated any capital, a little bit of insurance, but still I look back, if my whole salary had been taxed I would be much better off in terms of my social security payment than I am now.

Then I further recommended that we ought to tax the employer's full payroll. This will not produce a lot of money, but it is in the right direction.

Third, I made recommendation, since the hospital insurance program will be overfinanced because of the rise in the wage base, we could afford to take maybe two-tenths, four-tenths of hospital insurance program and apply it to the cash deficit.

Now, this is quite unlike what was recommended by the majority. We are not recommending any general revenue be put in, but plan an over-financing of the hospital insurance program because of the rise of tax base.

Finally, we recommended that this Congress needs to begin thinking sometime in maybe the next decade ahead about restoring to the Social Security Act the authority to use the general revenues. That authority did exist, I think, for a period of 4 or 5 years, but it has not been in the Social Security Act for a long time.

As you begin looking ahead even in the short term, sometime toward in the 1980's, maybe 1990's, unless you want to bring about, as the Administration wants to do, a very substantial increase in the tax rate, you are going to have to find money someplace, and it makes a good deal of sense for us to begin doing what was originally planned for in the social security system, use of the general revenues.

And I would love to have it debated, an argument on whether you find a formulation and produce it one-third from the employee's wages, one-third from the employer, one-third from the general revenue, and to have a real debate on whether that is really going to affect significantly the employee's attitude that he still has a right to the system.

I would grant if you get to the point where general revenues predominate, then I think there are some problems around, but no one has talked about that it has not even been considered. The eventual formulation would be one-third, one-third, one-third, and I am not convinced, and I think if you get some other authorities together you will find also that it is a debatable point as to whether you are at all threatening the right to the benefits you have earned because you use general revenue.

I could go on and develop this still further. Maybe later we might have a chance to have a talk going back and forth up front here.

I think under two formulations with the introduction of the general revenues maybe late in the 1980's, and not to a very significant amount at that particular point, that we will carry the system through this century without an awful lot of trouble from a practical standpoint.

I just finally want to close, Mr. Chairman, with this kind of a comment: You know, you have to look to the 21st century, too, and it has been very appropriately pointed out here we are going to have a lot more retirees than we have now, because some of the younger

crowd around now were very busy having children in the post-World War II period, and they are going to retire.

I cannot for 1 minute believe that the social security system in the U.S. Government is going to default on those people with respect to the retirement benefits. I don't, and no one can convince me otherwise on that.

I saw a cartoon in the Baltimore Sun here 2 or 3 weeks ago, showing a young child speaking to an older person, "Grandpa, will I be able to have social security benefits when I become as old as you?"

I am a grandfather, and I can tell my grandchildren, some of the young people around here, they are going to get their social security benefits because there is a commitment to social security on the part of the people of the United States and the Government that we are not going to deny.

A second factor is going to operate in this kind of a situation. If we hold to zero population growth—since this will mean smaller families, and if we have smaller families it is going to mean that we are going to have to spend less money on education, other child care costs, and so forth—there will be more resources available for the grandfathers of these children at that particular point.

Also, I am sure that with smaller families, with so many women we now have in the labor force, even more going to go into the labor force, from a practical standpoint that is going to build up the base from which you pay for your social security retirement benefits.

And thirdly, I think there is no question in my mind but a very desirable development will come about with respect to older people and I have worked with a lot of them. I can tell you that you talk about retirement as the golden years, but I have run across a lot of older people who really don't want to retire but they have to, either under union contracts or under the requirements of their employer. They don't want to.

You give them a chance if they continue working they would grab it and love it from a practical standpoint, and I think we are going to get to the point where we are going to need to continue to use the services of older people, and they ought to have a choice as to whether they retire or not.

But if they want to work, the opportunity should be there. Society needs them. It won't have to provide make-believe opportunities, substitute roles for employment that we now think is so necessary for old people. They can have a real part to play in society in America.

So I wind up, Mr. Chairman and members of the committee, by saying that I endorse very strongly the statement of the white paper put out by a group of social security experts, which I am sure you have all seen, four former Secretaries of HEW and three former Social Security Commissioners, in which they see problems ahead but they have no reservations but the Congress and the people can find ways to solve those problems to guarantee that the grandfathers of, the 2015's are going to have the social security protection.

Thank you very much.

Mr. BURKE. Thank you, Mr. Danstedt.

The next panelist is J. Henry Smith.

STATEMENT OF J. HENRY SMITH

Mr. SMITH. Gentlemen, much of what I have prepared has been covered I think quite well today.

I did undertake in the first part of this paper to take note of the wide differences in cost estimates.

Mr. BURKE. If you wish, your entire statement will appear in the record and you can summarize.

Mr. SMITH. Thank you.

[The statement follows:]

STATEMENT OF J. HENRY SMITH

I am J. Henry Smith, recently retired Chairman of the Board of The Equitable Life Assurance Society of the United States and a member of the 1974 Advisory Council on Social Security.

I am grateful for the opportunity to testify on the financing of the OASDI system because I feel that the matter needs to be placed in perspective before the public, and because early action by the Congress is definitely needed.

Recent studies and published reports and comments have found a sensitive ear among the public. In many cases undue alarm has been generated. Future cost estimates are most complex, and their implications are not easily understood. The differences in predictions that have appeared are disconcerting and may tend to throw doubt on the soundness or manageability of the system.

Somewhat in defense of my fellow actuaries who are called upon to make the future estimates, may I say that it is inescapable that the results will vary widely. A long-term projection of costs rests on a large number of economic and demographic assumptions as to future trends, the predictability of which is often quite low. The mere listing of the factors that must be taken into account suggests the dimensions of the forecasting problem. They include: Birth Rates, Death Rates for Different Groupings, Rates of Disablement, Rates of Termination of Disability, Survivorship of Dependent Beneficiaries, Trend of Wage Rates, Trend of Cost of Living, Composition of Labor Force, Unemployment Rates, Migration, Interest Earnings on Trust Fund, Administrative Costs as Affected by Inflation.

Some of the most influential of these factors have low degrees of predictability, especially rates of birth, and trends in wages and cost of living. And, of course, the need to project far into the future (because of the long-term commitments involved) seriously decreases the validity of the assumptions. Over long periods small differences in assumptions can accumulate to large differences in results. It must be expected, therefore, that different estimates, especially if separated by even a few months of time, will turn out differently—even to the extent of a 40% difference (recently appearing) in the percentage of payroll required to support the plan in the 57th year.

In spite of these uncertainties, however, it is important to make projections because we need to be prepared for reasonable possibilities. Projections should be updated frequently in order to keep Congress and the public informed of changing trends. In this respect, as a technical point, I personally favor having each computation bring out alternative estimates based on variations of the underlying assumptions—something like the high and low future cost estimates for OASDI that used to be prepared for Congress. Showing such a range is more consistent with the degree of reliability involved and would also help the public understand the true nature of the predictions.

Regardless of the variations, however, it is quite meaningful that all of the recent estimates indicate a substantial deficiency in the present provisions for funding the system. Fortunately, however, the bulk of the deficiency (whatever estimate is considered) lies well in the future. The estimates of near term deficiency, which are much more reliable, are much more consistent and manageable. They are significant, however, and it now seems clear that the current actual costs, plus the short range costs likely to materialize in the next several years, are such that Congress should take early action to shore up the funding of the plan. As an importantly related matter it should also deal with the problem recently brought forward in several quarters concerning the erratic, inconsistent, and seemingly capricious results obtained by applying the present benefit formula under varying conditions.

In framing recommendations for changing the financing, one ought to have an eye on deficits that may arise 40 or 50 years hence, but the principal focus for Congressional action surely will be the needs of the next 10 to 20 years. If the latter are met, part of the long-term future needs will be taken care of, and the rest can be met gradually in the future as more reliable estimates of the on-coming needs become practical.

So it seems to me that two recommendations for early action by Congress are in order:

1. A small increase should be made in the FICA tax rate (the Social Security contribution rate) to offset expected deficits over the next 10 to 15 years, and to replenish the social security trust fund to some extent;

2. The mechanics of the benefit formula for determining the Principal Insurance Amount (PIA) should be revised to make its results more stable and consistent in relation to wages. The formula should be "decoupled" as the current argot has it.

The second of these recommendations, i.e. for "decoupling" is explained and dealt with at some length in the report of the Advisory Council on Social Security. It is complex but seems to be non-controversial; it is in the nature of overcoming a flaw in the technicalities of the benefit provision. For support of this recommendation I will rely on the report of the Council without further argument here. Suffice it to say that the present coupled mechanism contributes substantially to the expected long-range deficit as computed for the present law.

The recommendation of a small change in the tax rate is a realistic, straightforward approach to funding. It has the full weight of precedent behind it—Congress has increased the rate again and again as the cost of the plan was raised. Of course, no one wants to increase taxes today, but with the very large increase in benefits that has occurred in recent years and the further increases that will probably come about in the future, it seems only proper and consistent to adjust the tax rate correspondingly.

To be more specific, I would recommend an increase in the tax rate in the neighborhood of one-half of one percent of wages, applying both to employer and employee, effective, say, January 1, 1976, or even at a date somewhat later than that if Congress feels it important to delay the increase until economic conditions improve. The exact figure to be used ought to be determined after careful review of the 1975 report of the trustees of the trust fund which, as I write this, I have not had an opportunity to study fully; but it is my belief that a tax increase in the neighborhood of 0.5% is the order of magnitude required for meeting the expected deficit over the next decade or so.

Alternative ways of meeting the deficit include deliberalizing benefits or conditions or eligibility; resorting to general revenues for funding; increasing the maximum earnings base for FICA taxes and OASDI benefit calculations; and wholly or partly diverting FICA taxes paid for Medicare to OASDI and making up any deficiencies thus created for Medicare by resorting to the general treasury.

The majority of the Advisory Council on Social Security voted to recommend the last mentioned device, but a substantial minority of us dissented. Our main objections were that it is simply a camouflaged way of resorting to general revenues, and it would interfere with the orderly funding of the Medicare system. Furthermore, shifting Medicare financing to general treasury revenues would threaten to turn it into a welfare, means tested, system instead of a social insurance program.

Of course, if we could be sure that the portion of the FICA tax now allocated to Medicare is, and will continue to be, excessive, some degree of diversion of it to OASDI would be in order. Whatever Medicare surplus now exists, however, seems almost certain to be temporary. The trend of health care costs has been sharply upward lately, and those of us active in health insurance who have had to cope with sharply rising health costs see little hope that we can avoid repeating the history of emergence of actual costs in excess of all estimates.

Any proposal to cure the OASDI deficit by deliberalizing benefits or conditions of eligibility seems politically unlikely. However, as suggested in the report of the Advisory Council consideration should be given sometime in the future to increasing the normal retirement age after it becomes clearer how the balance between labor needs and work force will develop over the years.

The alternative of shifting some of OASDI costs to general treasury revenues seems to me unsatisfactory. This is an old idea that has been debated many times over the years by the Ways and Means Committee. Its repeated rejection stems, I believe, from two strong arguments. First, the maintenance of a contin-

uous equation between benefits as related to wages and the special tax on wages is logical (especially under a pay-as-you-go system) and provides needed discipline and understanding by the public; and also it helps to account for the widespread public acceptance of the system. Second, injection of general revenues would tend to turn the plan away from respected insurance principles toward a welfare system which might easily be construed to require means tests and other regrettable features of philanthropic doles.

The other alternative of collecting more OASDI tax by raising the maximum taxable earnings base to some figure higher than the present \$14,100 will require serious consideration by Congress. I believe it would be a very unsatisfactory move for the following reasons:

1. Social Security from the beginning was intended to be only one of three layers, the middle layer, of the country's income maintenance system. The basic layer is the public assistance program and the top layer is that of private savings, pensions and investment. All have their proper place and should remain well defined and contained. Raising the maximum earnings base would cause Social Security to impinge on the top layer of private initiative and savings. It would extend coverage to a level of income where enforced, formulated disposal of income seems inappropriate under our general philosophy of individual initiative.

2. By thus eroding the top layer of private savings and investment the move would tend to reduce capital formation and that would be a serious deterrent to orderly economic development of this country. On every side we learn of current and future demands for capital that seem insatiable. Private savings and pension plans accumulate capital; the OASDI system does not do so appreciably.

3. Instead of spreading out the needed tax thinly over all of those benefitting from the liberalizations of the plan, it would concentrate the whole cost unfairly on a relatively small group, most of whom are already very hard pressed workers. If the maximum were raised to \$18,100, a person earning that amount would be called upon to pay almost \$200 more a year in FICA tax and his employer would match that increase. This is a serious drain, and we are not talking about affluent people but those whose income are at the level of, say, a carpenter or a New York City policeman, people on whom the sharply progressive income tax is already burdensome. If the maximum were raised, as some recommend, to \$24,000 the tax increase for a person earning that amount would be almost \$1,000 a year, split between the employer and employee. That amounts to a 70% increase in FICA tax.

4. A change of this type could well be considered by a large portion of the electorate to exaggerate what some consider the inequity of the present plan. The increase in tax would not be balanced by an increase in benefits for those paying the higher tax, at least not for a long time. There would be quite a lag before benefits for those whose taxes were increased would be correspondingly raised, and even then it must be remembered that the benefit system is very heavily weighted in favor of low income people. The troublesome question of "will I get my money's worth?" would be aggravated.

For all these reasons I believe that the appropriate alternative is to raise the FICA tax by a small amount at an early date. To do otherwise would do violence to the principles and basic philosophy of the system.

Mr. SMITH. I did undertake in the first part of the statement to take note of the wide differences that have appeared in long-range cost estimates for the plan, differences which come about with changing economic circumstances, and assumptions different at times and at times fairly close together. We have had wide differences in the expected cost, long-range cost of the system.

I thought it might be useful to insert here some explanation of why the actuaries end up with such widely differing numbers.

I have listed, for example, some of the factors which have to be taken into account in developing costs, and as you may see from page 2, or page 1, the bottom of page 1 of this statement, there are quite a number of very important and difficult-to-predict forces that influence the long-range cost elements.

On the other hand, the short-range cost elements, cost projections, are more dependable and more consistent, and I think Congress should focus on them at this time.

My statement suggests and recommends that this matter of changing the benefit formula to eliminate the flaw which Mr. Van Gorkom discussed should be attacked by Congress promptly.

As for the financing aspects, the problem of meeting the short-range deficit, I lean in the direction of increasing the social security tax rate by a small amount sometime in the relatively near future, not necessarily right away but with a few months' time, let's say, or perhaps a year's time.

I would pick up the arguments for that beginning on page 4 of my statement, if you care to follow what I read.

The recommendation of a small change in the tax rate is a realistic, straightforward approach to funding. It has the full weight of precedent behind it—Congress has increased the rate again and again as the cost of the plan was raised.

Of course, no one wants to increase taxes today, but with the very large increase in benefits that has occurred in recent years and the further increases that will probably come about in the future, it seems only proper and consistent to adjust the tax rate correspondingly.

To be more specific, I would recommend an increase in the tax rate in the neighborhood of one-half of 1 percent of wages, applying equally both to employer payroll and employee wages, effective, say, January 1, 1976, or even at some later date than that if Congress feels it important to delay the increase until economic conditions improve.

Alternative ways of meeting the deficit include deliberalizing benefits or conditions or eligibility; resorting to general revenues for funding; increasing the maximum earnings base for FICA taxes and OASDI benefit calculations; and wholly or partly diverting FICA taxes paid for Medicare to OASDI and making up any deficiencies thus created for Medicare by resorting to the general treasury.

The majority of the Advisory Council on Social Security voted to recommend the last-mentioned device, but a substantial minority dissented, as just recently discussed by Mr. Danstedt, and I concur in his position in opposition to that recommendation.

Of course, if we could be sure that the portion of the tax now allocated to Medicare is, and will continue to be, excessive, then some degree of diversion of it to OASDI would be in order. Whatever Medicare surplus now exists, however, seems almost certain to be temporary.

The trend of health care costs has been sharply upward, and those of us who are active in health insurance who have to cope with sharply rising health costs see little hope that we can avoid repeating the history of emergence of actual costs in excess of all estimates.

Any proposal to cure the deficit by deliberalizing benefits or conditions of eligibility seems politically unlikely. However, we could, as suggested in the Council report, later look at the question of whether the normal retirement age should be changed. But I think that is something for the future.

The alternative of shifting some of OASDI costs to general treasury revenues seems to me to be unsatisfactory. This is an old idea that has been debated many times over the years by the Ways and Means Committee.

Its repeated rejection stems, I believe, from two strong arguments:

First, the maintenance of a continuous equation between benefits as related to wages and the special tax on wages is logical, especially under a pay-as-you-go system, and it provides needed discipline and

understanding by the public. It also helps to account for the widespread public acceptance of the system.

Second, injection of general revenues would tend to turn the plan away from respected insurance principles toward a welfare system which might easily be construed to require some major means tests.

The other alternative of collecting more OASDI tax by raising the maximum taxable wage base again to some figure higher than the present \$14,100 will require serious consideration by Congress. I believe it would be a very unsatisfactory move for the following reasons:

First, social security from the beginning was intended to be only one of three layers, as discussed by Mr. Van Gorkum a short time ago. All of the layers have their proper place and should be well defined and contained. Raising the maximum earnings base would cause social security to impinge on the top layer of private initiative and saving. It would extend coverage to a level of income where enforced, formulated disposal of income seems inappropriate under our general philosophy of individual initiative.

Two, by thus eroding the top layer of private savings and investment, the move would tend to reduce capital formation and that would be a serious deterrent to orderly economic development of this country.

On every side we learn of current and future demands for capital that seem insatiable. Private savings and pension plans accumulate capital; the OASDI system does not do so appreciably.

Third, instead of spreading out the needed tax thinly over all of those benefiting from the liberalization of the plan, it would concentrate the whole additional cost unfairly on a relatively small group, most of whom are already very hardpressed workers.

If the maximum were raised to \$18,100, for example, a person earning that amount would be called upon to pay almost \$200 more a year in FICA tax and his employer would match that increase. This is a serious drain, and we are not talking about affluent people but those whose incomes are at the level of, say, a carpenter or a New York City policeman, people on whom the sharply progressive income tax is already burdensome.

If the maximum were raised, as some recommend, to \$24,000, the tax increase for a person earning that amount would be almost—

Mr. BURKE. Sir, May I interrupt you? There is a rollcall vote on the floor. We will have to go and vote. If the panel will just wait, we will be back in a few minutes.

[A recess was taken.]

Mr. BURKE. The subcommittee will come to order.

We are sorry for the interruption, Mr. Smith, but we will now continue.

Mr. SMITH. It is remarkable how fast you can get back these days.

Mr. BURKE. We now have electronic voting. It doesn't give you much time to make up your mind.

Mr. STEIGER. It is one-third thinking, one-third punching, and one-third walking that makes the system work.

Mr. SMITH. Shall I continue, sir?

Mr. BURKE. Yes.

Mr. SMITH. I was giving my reasons for recommending against the change in the maximum wage base, and I was down at the bottom

of page 7 of my statement; the last sentence there, or next to the last sentence.

If the maximum were raised, as some recommend, to \$24,000, the tax increase for a person earning that amount would be almost \$1,000 a year, split between the employer and employee. That amounts to a 70 percent increase in FICA tax.

Four, a change of this type could well be considered by a large portion of the electorate to exaggerate what some consider the inequity of the present plan. The increase in tax would not be balanced by an increase in benefits for those paying the higher tax, at least not for a long time.

There would be quite a lag before benefits for those persons whose taxes were increased would be correspondingly raised, and even then it must be remembered that the benefit system is very heavily weighted in favor of low-income people. The troublesome question of "Will I get my money's worth?" would be aggravated.

For all these reasons I believe that the appropriate alternative is to raise the FICA tax by a small amount at an early date. To do otherwise would do violence to the basic values of the system.

Incidentally, I would like to endorse the independent research idea which Mr. Wallis put forward in his testimony. I do believe that there are major issues in this field which have not been adequately plumbed and which should be given full and careful, competent study before another Social Security Advisory Council is asked to give its views on things. I believe that is a very worthwhile idea.

Mr. BURKE. Mr. Steiger.

Mr. STEIGER. Mr. Chairman, I want to compliment all of the members of the Advisory Council, and I want to especially compliment Chancellor Wallis, who has a knack, it seems to me, for finding himself in different positions on councils and positions on advisory councils of various kinds, and has come through remarkably unscathed and is doing an exceptionally fine job.

If I can, let me go to some things you didn't touch on in your prepared statements and just see if I can get a better understanding.

In the fourth chapter on the retirement test you deal with—

Mr. DANSTEDT. What page is that?

Mr. STEIGER. Page 21. You deal with six issues. I came away from reading that section of the Advisory Council's report frankly not very persuaded, at least in what you presented to us, with why you don't think some changes are needed or should be undertaken.

If I can, can I go then to at least three of the provisions, that is to say, section 6 on taxes on earnings after 65, why you don't think we ought to eliminate the tax on those receiving benefits; secondly, to the question of liberalizing the provisions of the retirement test; and thirdly, the monthly pressure of retirement versus annual.

If I could, Chancellor, perhaps if you want to or whoever wants to answer, I really am not satisfied with the recommendations that you make and I am not persuaded by your reasoning. If you can help me, I would be grateful.

Mr. WALLIS. Thank you very much.

I would like to make one general comment which is suggested by this question. There are, of course, quite a number of topics covered in the report which none of us have touched on. We have focused on

those that are primarily financial, and certainly there is nothing in the report, or practically nothing, that doesn't have some financial implications for the system.

Now, with respect to the retirement test, that would have some financial implications. I would say I also am not satisfied with that section, and I think it is probably true—I would have to check my memory or the minutes, but I think it is probably true—that nobody on the Council is satisfied with that section.

That was the one section where we had an extreme range of views; from those who felt the retirement test ought to be abolished completely—once a person gets to be 65 he should get his social security benefits whether he had earnings or not—to those who felt he shouldn't get a penny, and that we already go too far in exempting \$2,520. The Council simply worked around until we found an intermediate position. As I remember—

Rudy, was it unanimous? It was close to being unanimous.

Mr. DANSTEDT. It wasn't enthusiastic.

Mr. WALLIS. No, I think not unanimous. But you are used to that in the Congress, you always have to give up something to come to an agreement. This was a case where the Council took one of those practical positions; maybe we should have left it for Congress to do the compromising and each of us stated his own views.

I personally am not satisfied with it at all, but other people were dissatisfied in exactly the opposite direction.

Mr. DANSTEDT. I am willing to stick my neck out. I guess you could call me the conservative on this. I thought the present amount that we get, which is not a large amount of money, does a pretty good job. I have seen some tables somewhere and supplied by the Social Security Administration which indicate that you can actually move up to earning \$8,000 or \$9,000 a year before you lose all your social security benefits, and that is one factor that needs to be considered.

And second, at least I and several others were not convinced that this retirement test would do the average person much good, would primarily benefit professionals who were able to continue on working after 65.

Mr. STEIGER. Go ahead.

Mr. VAN GORKOM. It is without question the most troublesome question that we had, because the basic principle of paying on the basis of right has been compromised already. In other words, the idea is, well, you pay for social security; therefore, when you are 65 you should get it.

But the basic underlying more specific philosophy was it is a wage replacement program and therefore if you continue to work and gain wages you should not get your benefits.

The trouble with that aspect is you can say, well, here is a man who could continue to work but chooses not to work, and yet he gets the benefit. So yet it isn't really based on your loss of ability, it is based on your decision not to work.

Second, it was compromised further when they decided to let people make as much money as they wanted to after age 72. Now, the compromise comes about in this case. First, it would be very expensive if you were to eliminate it. The cost, as I recall, was somewhere between \$6 billion and \$10 billion a year, to eliminate it entirely.

Mr. JACOBS. Will the gentleman yield on that point?

Last January, the Social Security Administrator said \$4 billion.

Mr. VAN GORKOM. \$4 billion.

Mr. SMITH. It was a later figure.

Mr. WALLIS. \$4 or \$5 billion.

Mr. VAN GORKOM. All right, \$4 billion or \$5 billion, that was a consideration.

Second, we knew that OASDI faced a very sharp financial problem, facing a 3-percent deficit and now facing a 5.3-percent deficit, and we knew financing would be very important. Therefore, we felt—and as Mr. Danstedt said, then who is going to be benefited by this, and the answer is, under the present law you can make \$2,500 before you lose your benefits. Let's say you are getting a benefit of \$2,400, which would be \$200 a month, which would be a very reasonable benefit. So your income from social security is going to be \$2,400. You can also make \$2,500 without losing any benefits, so it is only somebody who is going to make over \$5,000 a year, who would be hurt by this restriction.

And while we felt that the retirement test was illogical in many ways, we felt—well, look, we are only going to have so much money, and if it is going to cost \$4 billion to eliminate the retirement test, and those people affected by it are generally getting along better than people at the bottom of the totem pole, that was just another compromise, that is all it is.

Mr. ARCHER. While you are on that, though, if you assume that the amount of earnings would be related to the degree of productivity, in the system, to say that the only people who would benefit out of it would be the ones who could produce the most, who would make the greatest economic contribution, then are we not shutting off this economic productivity which this country desperately needs?

Mr. VAN GORKOM. Well, we are certainly all disturbed by the fact that the plan does discourage people from working; that is a definite fact that we are all unhappy about, as Mr. Wallis said.

As you say, it is perfectly true we shouldn't have a system that discourages people from working if they want to work, and this system does, and that is what bothers us.

Mr. DANSTEDT. Also, I might add in today's labor market, who is going to hire someone over 55 unless he has got some unusual skills?

Mr. ARCHER. Well, that is all the more reason, though, if a person has an unusual skill and experience and capability to implement in society, it ought to be implemented.

Mr. DANSTEDT. There is nothing to stop him from doing it. He can go ahead and work anyhow.

Mr. ARCHER. Well, but he has got the disincentive that he is going to lose his social security benefits.

Mr. DANSTEDT. But they are lost.

Mr. ARCHER. Don't we have to look at our overall Nation and overall economy, rather than just segment to social security? Either we are going to build a bigger pie for everybody to share in, or we are not going to have as much for everybody, and anybody who doesn't work because of the fact that he is going to be penalized by losing his social security benefits is shrinking the pie rather than expanding the pie of economic productive effort that we all share in.

Mr. WALLIS. That is an argument which we weighed heavily. It was brought up. It wasn't put that well, but I think a number of us did weigh that very heavily.

I was one who preferred to see the whole thing abolished.

Mr. STEIGER. Can I ask just one more question, Mr. Chairman, before my time runs out?

Mr. BURKE. Yes.

Mr. ARCHER. Sorry.

Mr. STEIGER. No problem.

Chancellor, in your statement, you go at this question of a totally independent nongovernmental body studying, obviously, exceedingly complex issues in the social security system. Is this the recommendation of the Council, or is this your personal recommendation, No. 1? And secondly, is it your recommendation, no matter from whence it flows, that Congress ought to establish this kind of body this year in order to give that kind of independent group enough time to develop what it needs prior to the time the next Advisory Council is appointed?

Mr. WALLIS. Well, first, it is the recommendation of the Council. On page roman xvi of our report, it is summarized, in the very last paragraph. It says that further study is needed. Then, it says, in addition, that a general study of social security should be made by a full-time, nongovernmental body, covering such matters as—and then my statement copies the rest of that sentence. And it is expanded on further in another chapter. but I am afraid I can't find it immediately. I think it is a chapter I—yes; it is on page 5 in the second paragraph.

With the convergence of so many unprecedented developments, it is not too dramatic to say that the social security program is at a juncture of decisive importance. Major aspects of social security that deserve attention, but that the Council did not have time to analyze thoroughly, include: full reserve funding versus current cost financing; the effects of social security on productivity, capital formation, and private savings; the relationship between private pensions and social security; and the appropriate size of the trust funds. To lay the groundwork for the next Advisory Council on Social Security, a comprehensive study of these and related issues should be conducted by a full-time, nongovernment body, such as a research organization experienced and qualified in the public policy field. These studies should be under the general guidance of a board composed on much the same criteria as the law specifies for Advisory Councils on Social Security.

As to whether Congress should be urged to act promptly on that. I don't know whether Congress should act on that at all, or whether somebody should try to persuade a private foundation, as was the case with the Russian study, to finance such a study.

Mr. BURKE. Could I interrupt you?

Mr. Kelley, what about the study that is going on right now?

Mr. KELLEY. We have a study that is just being initiated right now. The Senate Finance and Ways and Means Committees have contracted through the Library of Congress to have a group of actuaries and economists work with the Social Security Administration in putting together information that has never existed up to now, which will help us, I think, to come up with better approaches to the long-range financing situation.

Mr. CONABLE. That certainly wouldn't be the study requirements that you are recommending, because that is being put together with the Social Security Administration itself.

Mr. KELLEY. I think, perhaps, we won't have any definitive results for about a year or so. This shouldn't hold up action on the short range, but it will be of great assistance in attacking the long-range problems.

Mr. STEIGER. My reason for raising this is, it is not clear to me in your statement, as whether or not you thought, in fact, this is something that ought to be mandated. I must admit, I am not quite sure how we do that to get somebody who is independent in the sense that you did with the Russian studies.

Mr. WALLIS. Yes. We said it ought to be done and did not say how it should be done.

I don't think that it is something Congress can do. How can Congress do it? This could be a nongovernmental study. Well, of course, Congress could appropriate a big chunk of money the way a private foundation does, but even appropriating the funds gets to be complicated. So, I think it is not possible.

I agree with the study that Mr. Kelley describes. It is a very useful thing to do, and I wish it had been done before our Advisory Council went to work. I am sure the next Council will benefit from it, but it does not meet what has been suggested here.

Mr. SMITH. Incidentally, one of the items I think should be listed for study—it was hoped would be studied, but never got around to—is the problem of disability benefits, benefits to those who become disabled.

The Ways and Means Committee has been, in the past, concerned, and properly so, with the fact that experience in that part of benefits has been running ahead of income. And further, not only has it—

Mr. CONABLE. Soared, recently.

Mr. SMITH. Yes; not only benefits going up, but complications of administering that kind of benefit have been rather horrendous, and the courts are rather badly overwhelmed with cases. A lot of thought is needed on that whole phase of the system—it needs very careful study. We didn't get to it.

Mr. STEIGER. Thank you, Mr. Chairman.

Mr. BURKE. Did you wish to comment, Mr. Danstedt?

Mr. DANSTEDT. If I may comment on that, certainly anybody going through this process recognizes a study requires a great deal more depth than we had time to do. However, I have an instinctive reaction to turning this study over to some outside private group.

I would rather see the next Social Security Advisory Council so engineered and handled that it itself could plan to commission some of these studies in appropriate areas, you see, because it has funds available to it. And I would like to see the whole thing tied together.

I mean, I think, the importance of the Advisory Council, from my experience, is as kind of a citizens body of review, that, you know, has some control over the study, to have some control over the recommendations to come out and all that.

And I have an instinctive concern about turning it over to any one, outside group, at this point.

Mr. VAN GORKOM. Mr. Chairman?

Mr. BURKE. Yes.

Mr. VAN GORKOM. The problem, of course, I think the thing that needs to come out of all of this is that the Advisory Council felt very

definitely that the Advisory Council mechanism is not adequate to this job.

The problems which we ran into are so broad that even the normal time of 18 months is not enough to address itself in a definitive way to some of these very basic problems that Mr. Wallis has raised. We only met for 10 months. And that is the reason—the Advisory Council does not meet long enough. It is not in existence long enough, really, to tackle these problems.

Of course, it doesn't have the authority to do so. I suppose the authority could be expanded, but if you are going to turn this over to Advisory Council, I think the Advisory Council should be substantially longer in term. These problems are very basic to the whole future of social security, and they take a lot more time than an advisory council would ever have.

Mr. BURKE. Actually, the law, I think, called for the members of the Advisory Council to be appointed before January, and they weren't appointed until April.

Mr. VAN GORKOM. We were appointed a year from January. We were appointed over 12 months late.

Mr. CONABLE. They wouldn't have been appointed then if this committee hadn't really leaned on the administration.

Mr. VAN GORKOM. Well, we appreciate that. We all got so interested in that, but realized in order to do a really good job the Advisory Committee has to have answers to some of these.

Mr. BURKE. It has to have more time, no doubt about that.

Mr. VAN GORKOM. Yes.

Mr. BURKE. Mr. Cotter.

Mr. COTTER. Thank you, Mr. Chairman.

Mr. Wallis, to get back to the line of questioning first pursued by Mr. Archer, where you suggest that this independent group studied such fundamental issues as "full reserve funding versus current cost financing," I presume you mean to put the fund on an actuarial basis, such as private pension plans?

Mr. WALLIS. That doesn't mean me, personally, but there are people advocating that. There ought to be studies. It doesn't strike me—maybe if I saw a good piece of research on it, maybe—

Mr. CONABLE. How much would that have to be?

Mr. COTTER. That is what I was going to pursue.

Mr. VAN GORKOM. Mr. Feldstein, in his paper, estimated \$2.4 trillion.

Mr. COTTER. Trillion?

Mr. VAN GORKOM. That is the total actuarial obligation today.

Mr. COTTER. That is to put it on an actuarially sound basis as of today?

Mr. CONABLE. Will the gentleman yield?

We better wait until the national debt amounts to that, if we don't want to have social security own all the corporations in the country.

Mr. VAN GORKOM. That is exactly what it would be.

Mr. BURKE. That is in 75 years, isn't it?

Mr. WALLIS. That is far in excess of the value of all the stocks on the U.S. Stock Exchange.

Mr. COTTER. What do you actually mean by "full reserve funding"?

Mr. WALLIS. Well, in particular, as I say, I don't see any sense to it, but it is advocated. In particular the Wall Street Journal is always running editorials saying that we ought to do that.

Mr. COTTER. Well, it is out of the question.

Mr. BURKE. Well, where would they invest the funds?

Mr. WALLIS. Don't ask me. But it is something people advocate and ought to be investigated.

Mr. COTTER. You don't agree with them?

Mr. WALLIS. I agree——

Mr. BURKE. What effect would it have on the savings institutions of this country—what effect would it have if they tied up all that money in the social security trust fund?

Mr. SMITH. It would kill them.

Mr. WALLIS. Well, apart from whether it would have been a good idea in 1935, it is not 1935 anymore, and as somebody indicated over here, even if it would have been a good idea then, it is too late now.

Mr. COTTER. Yes; we are beyond that.

Mr. WALLIS. But we are talking here, really, about some thorough research and investigation. There are people who are able to get their voices heard and who advocate full funding, and it is one of the things that ought to be studied.

Mr. COTTER. You just want the air cleared on the thing? I mean, in your opinion, it is completely unrealistic?

Mr. WALLIS. I personally would be willing to predict how such a study will come out; yes. But Mr. Feldstein, I suppose, will predict the opposite when he is here tomorrow. And I suppose some other people will.

Mr. VAN GORKOM. And he is not a small voice. He is a very respected individual, so you can't just brush it off.

I think, what Mr. Wallis means, when the next council comes to sit down to the table, if the basic principles have been established and agreed upon, it would make their work much more meaningful, I think, if they didn't have to try to come to grips with these things at the same time they are laboring with the retirement test.

Mr. COTTER. One other test, Mr. Danstedt, I know you are opposed to loosening up of the retirement test.

Mr. DANSTEDT. Yes.

Mr. COTTER. Does this represent the position of the national council?

Mr. DANSTEDT. Yes.

Mr. COTTER. It does?

Mr. DANSTEDT. National council; yes.

Mr. COTTER. That is interesting, because every group I go before—senior citizens, ARPA—asks one question: "What are you going to do for us; you have got to do something," and I mean there are more bills before us loosening up.

Mr. DANSTEDT. This is a solid position that we have that has been considered at our regular constitutional assemblies, and there has never been any really serious debate on the whole thing.

As a matter of fact, there are even some segments of our membership, the UAW crowd in particular, who think the retirement test too high now, and it is encouraging a lot of scab labor, they think.

Mr. COTTER. That is interesting, because wherever I go before senior citizens groups, this is the one thing they want eliminated.

Mr. WALLIS. This brings out another example of the need for basic research. As I indicated earlier, we all agreed that the retirement test has some disincentive effects on work, reduces output of work; but nobody knows how much, and this would be one thing for a good research study to try to estimate. The effect could be very trivial or it could be very great.

The most we can say is, it stands to reason that it must have some effect; but there is no way to know how important that effect is, so, therefore, we don't know how heavily to weigh it.

Mr. DANSTEDT. The fact that it operates in these things is not too logical. There is a lot of griping about people having income from investments—you see—don't continue to still draw their social security payments, you see. But then, there is a lack of understanding of the whole social security system as a retirement system, and they object to that.

Well, I think this enters the picture—why should these people be able to hold on to their income from investments, but we can't hold on to our income from jobs?

Mr. COTTER. That is a logical argument.

Mr. DANSTEDT. Well, not in terms of the purpose of the social security.

Mr. COTTER. No; not as far as that is concerned, certainly.

Mr. JACOBS. Will the gentleman yield?

Mr. COTTER. Yes.

Mr. JACOBS. If there is creeping into the social security program a theory of a means test at the lower end and if anyone approves of that, what is so heinous about letting the same thing creep in at the other end?

If a person has a half-billion dollars a year unearned income, why should that person, having paid his fair share of taxes, as I did, to educate the neighbors children—why should that be?

Mr. DANSTEDT. Well, I am unaware of the fact that there is any income test creeping into social security at this point.

Mr. JACOBS. Well, I would like to discuss this with you.

Mr. DANSTEDT. Only in relation—

Mr. VAN GORKOM. General revenues.

Mr. JACOBS. You say bottom end, if you are having supplemental SSI, why the logic at the other end?

Mr. DANSTEDT. Well, except SSI wasn't constructed as retirement system, national welfare system.

Mr. JACOBS. Do you get me?

Mr. DANSTEDT. Yes; I get you.

Mr. PICKLE. Well, Mr. Chairman, isn't the problem now the people and the Congress, or both, have come to view the social security program now as a needs test?

Mr. VAN GORKOM. No.

Mr. PICKLE. We don't make payments so much on amount of earnings, but because people come to think that they need more benefits, they need more money, and it is really just sort of a need matter now, almost welfare, instead of retirement.

Now, you don't agree with that?

Mr. JACOBS. Well, he does agree with that.

Mr. PICKLE. Well, that alone, but really the public has come to view it as part of the needs.

Mr. VAN GORKOM. They know that up until now they don't get more benefits unless they pay more taxes, that relationship has been drilled into their minds over 40 years. And so, to date, you cannot say that.

They feel, people who have been hurt, particularly at the low scale by cost of living, how it is ruining their wage increases, feel the pinch very much, and the retired people always do.

Mr. PICKLE. People say that they want social security benefits raised because they need more money. They don't relate it to what they have earned. They just need more money.

Mr. VAN GORKOM. No; but they know that in the past, when they got more benefits, the tax would go up, too.

Mr. PICKLE. They may know, but they don't admit it.

Mr. VAN GORKOM. Already required and not being taxed——

Mr. BURKE. Mr. Conable.

Mr. CONABLE. Thank you, Mr. Chairman.

It must be a frustrating thing to just scratch the surface with your council when you do start, and I am asking a couple of exploratory questions, whether you considered this or have any general thoughts on it.

First of all, with respect to the general treatment of men and women, there is a lot of feeling among working women that this program was designed in 1935 when very few women were in the work force and the emphasis was put on the family unit; therefore, the working woman is seriously discriminated against in that most of her contributions if she is a comparatively intermittent worker go right down the drain as far as her benefits are concerned, because she is likely to draw on derivative basis, based on her husband's earnings.

Is there any serious thought that the whole system should be restructured to reflect the current state of the work force, rather than the state of the work force in 1935 when because of the depression women were largely excluded from productive jobs?

I notice that there is a statement here under the item "Treatment of men and women," and I think the last sentence, other provisions of the social security program which are the same for men and women, but which are criticized because they appear to have different average effects on men and women, should not be changed. Is that intended to brush off this question, or was that seriously considered?

The second question I would like to ask, and you can answer either one to any degree that you want, is, do you see any possible move to tax social security benefits under the income tax system if our pensions, the social security pensions expand quite sharply as a result of the expansion of the wage base? We have had some feeling in the past that if people are paying a payroll tax on the basis of a very large wage base that they should not expect their pension benefits to be totally income tax exempt thereafter, and that this is a different way to approach the problem of need. That would perhaps be more acceptable than weighing it in such a way that you say to the average workingman, "Sucker, you have been just paying another tax instead of investing in your retirement."

Mr. WALLIS. Well, let me try to start answering those questions, and maybe some of the other Council members here would like to add to my answers.

First, your reference to it being frustrating to be on the Council. Well, it is in a way; if you thought you were going to answer all the questions of social security, you would certainly go away frustrated. I didn't start with any such hopes or expectations. I certainly hoped that we could make some contribution, and I must say that I enjoyed very much working with the people on the Council.

You know, the Council was specified to represent different groups, and we got more diversity than we would have gotten on the Council if it hadn't been for that. I think that all these different groups developed a high respect for each other's points of view that they might not have had if they hadn't come to know each other personally. I did. I think, also, we did make some recommendations that if adopted will be extremely important to the social security system, and specifically the one about correcting the automatic adjustments for inflation.

The way that stands at present, it could really blow the system sky high. It has removed the replacement ratio completely from the control of Congress or anyone else, or from the possibility of predicting what the replacement ratio will be, much less controlling it. I think that the recommendation we have made is a very sound one, and it is basically simple. It is pretty hard to explain it to the public, but still it is a simple one and a workable one and sound.

As has been pointed out before, it is essentially noncontroversial, and I think probably has a pretty good chance of adoption under those circumstances, so if that happens I will be satisfied that we did something big and important for the social security system.

Now, as to the question of treatment of men and women under social security, I personally am less satisfied with that part of the work of the Council than with any other part of our work. There are a lot of things that happened there to make that frustrating. We had a subcommittee on the subject. The reports that they brought in were not ones that the Council could get its teeth into, or could adopt verbatim as we did the report of the Finance Subcommittee. There was not unanimity in the subcommittee.

The problem there has been growing for a long time. The system is built on the assumption that families consist of a husband, a wife, and children, and that the husband earns all the income; that it is always the same husband and wife together all through life. Well, of course, now many people changed husbands and wives, some of them, quite a few times. Often there are living arrangements different from the traditional family. Something like 90 percent of women participate in the labor force at some time during their careers, over 50 percent in any one year, and over 40 percent at any one time.

Mr. CONABLE. According to—as before——

Mr. WALLIS. That is a totally different problem. There were various suggestions made by the subcommittee. The subcommittee, we felt, could not possibly digest them in the time available and come up with anything really sound.

For example, there was a proposal that all secondary benefits be abolished. No woman—or man—would get any benefits by virtue

of being married to somebody qualified for social security. It was argued that unless you go that far you will never get the problem out of the way. Well, maybe that is right. The Council just didn't have a chance to work that through. As I say, that would be pretty radical.

Mr. CONABLE. Never get that through Congress, anyway. I mean, not that something shouldn't be done.

Mr. WALLIS. Yes; or through the Council, unless you have pretty well overwhelming evidence. So all I am saying is that is one of the completely unfinished agenda of this Council, that the next one is going to have to work on.

On the question of proposing that social security benefits be subject to the income tax, that was discussed, but not very much. I personally think that definitely ought to be done, and if it were done it would reduce some of the other problems, like that of people who have a very large amount of investment income and get social security, and the problem of the retirement test. Since wealthy people are taxed in the 71-percent bracket, the amount of money they would pocket by drawing social security wouldn't be as important as at present.

There are a number of other excellent points—Mr. Van Gorkom referred to Government employees and others who qualify for pensions, and then qualify for the minimum social security pension, getting the ballooning that is put in on the assumption that if you are at the minimum you are poor. I think the estimates were that 35 percent of those receiving minimum payments were not in any sense poor. If they were being taxed under the income tax, some of the inequity would be taken care of. However, I am just speaking of my own impressions on this issue. It was not really seriously discussed as far as I recall by any of the others.

Mr. SMITH. I would like to add a point there. I think this is an important question which ought to be faced. It would be extremely difficult politically, I think, to make an important change there, but in the long run this could be the solution to a lot of problems and certainly has a great deal of rationality behind it.

Mr. CONABLE. If you did it, sir, you would certainly have to greatly increase the exemptions for people over 65 to compensate to some degree for it.

Mr. SMITH. Well, perhaps.

Mr. CONABLE. It still would be a very difficult thing to do politically; you are right about that.

Mr. SMITH. Yes. For instance, someone said it would solve a lot of problems to cut out income test. Such trouble is partly due to the fact benefit is nontaxed. If it were taxed, then you could say people who were going to draw benefits while working will be taxed for their total income, whether by earnings or by investments or unearned income. This is one of the things I think a study ought to be made on and the Council could very well have on its agenda.

Mr. BURKE. Would you exempt the social security tax, exempt it from the income tax?

Mr. CONABLE. At the other end?

Mr. BURKE. At the other end; as is done under the Keogh plan, exempt it up to \$7,500 a year?

Mr. SMITH. Yes; I think that is a logical suggestion, too, to be considered.

Mr. WALLIS. We haven't gone into that.

Mr. SMITH. That is my own view.

Mr. WALLIS. We started to go into a question like that, whether their benefits when they are paid out would have to be regarded to a certain extent a return of the beneficiary's funds, as they are under private pension plans. It was pointed out that this would really get you into infinitely complicated accounting. The system already is beyond the comprehension of most beneficiaries, and it would be beyond the comprehension of even the Social Security Administrators by that time.

I personally do not think it would be necessary to do either of those two things.

Mr. DANSTEDT. Mr. Chairman, sometimes we are discussing this matter at the Council and we were feeling that the talk had almost dissolved social security, that the persons on social security were affluent and semiaffluent. I don't have the figures on hand, but if I recall correctly this is the order of magnitude.

Social security is the only income for about 50 percent of the people who receive social security, and I don't know what the highest is now for a couple, but I don't think it is much over \$4,000, if you come right down to it. The average benefit, for example, I think, for an individual, is not too far above the poverty level, nor is the average benefit for a couple too far above the poverty level. So it seems to me, you know, when you are talking about excluding their social security payment from Federal taxes, then you really begin touching on people who are at the bottom of the income scale whoever you are talking about.

Mr. CONABLE. I think you mean just the opposite, sir, but maybe I am wrong. I think I misunderstand.

Mr. SMITH. Those are the ones who would not pay.

Mr. DANSTEDT. Oh, because of the income tax law; yes.

Mr. CONABLE. Yes.

Mr. BURKE. There would have to be limitations on such an amendment.

Mr. DANSTEDT. Yes; I can see it balanced out in some way, but the only point I was making was—

Mr. BURKE. Because it is interesting to note, under the Keogh plan \$7,500 a year can be put away in the plan and no income taxes are paid on that \$7,500, and interest earned on it. You could do that for 40 years, 45 years, but that 5.85-percent social security tax is paid without regard to income taxes.

Mr. CONABLE. Comes out after taxes.

Mr. BURKE. So it comes out after taxes.

Mr. JONES. Thank you, Mr. Chairman.

One of the suggestions to finance the system was the 1-percent increase in the taxes. Another was to drop medicare from the trust fund, and have it financed by general revenue. If you finance medicare by general revenues, would there be a need for increase in the tax?

Mr. VAN GORKOM. Not in the OASDI tax, because of the amount of the reduction in the medicare positions of the tax, it could be as much as you want. I think the present OASDI tax is 1.8 percent; 0.9 percent is paid by each—0.9 percent is paid by the employee and the same by his employer. But I would like to make one thing very clear.

The Council, at least I, and I think most of the members who voted for general revenues to support the medicare part, did not do that in order to bail out the OASDI system. They did that because they felt the medicare never should have been financed from wage taxes, it should have been taxed from general revenues from the beginning.

It so happens that it bears on the problem that we are faced with, and that is how to continue increasing the OASDI benefits without raising the tax. As a matter of fact, John Byrnes was on our Council—who was in the Congress at the time—in fact, he was in the Congress when Social Security was passed.

Mr. STEIGER. No, no, no, he was not.

Mr. VAN GORKOM. When medicare was passed.

Mr. STEIGER. He had been there a long time, but not that long.

Mr. VAN GORKOM. When medicare was passed there was a big argument about it.

Mr. CONABLE. I don't want to disillusion you, sir, but John no longer is a member of the Ways and Means Committee. Ways and Means would lose medicare if not taken out of the General Treasury.

Mr. VAN GORKOM. I see; I am sorry.

Mr. JACOBS. It was taken out?

Mr. VAN GORKOM. The answer is, if you took it out.

Mr. JACOBS. You could actually retain?

Mr. VAN GORKOM. If you wished to; yes. Or you could just take part of it from General revenues and balance it out that way.

Mr. JACOBS. Now, did you discuss the cost-of-living increase as an automatic raise in social security; and do you have any recommendations as to that, as to changes that may be necessary?

Mr. VAN GORKOM. Well, there was discussion as to that. In fact, the Vice Chairman raised the point—that is, Mr. Weber—as to whether we could continue or should continue, to completely isolate one segment of the population against the ravages of inflation, where no other segment was so fully protected. It was thought maybe it might at least be considered whether we should only protect them for a part of the increase in inflation. Only raise benefits every other year, or increase it by half the increase of inflation.

But there was not a great deal of discussion along those lines because it was generally considered by the council, I think, that any effort to reduce benefits, and that would constitute a reduction in benefits, would be virtually impossible.

Mr. DANSTEDT. We did reach a decision, didn't we, that maybe we ought to review, there ought to be a review of the frequency of cost-of-living adjustments, I recall?

Mr. VAN GORKOM. And we had a computation made as to whether every other year instead of every year.

Mr. DANSTEDT. And also the element.

Mr. BURKE. Some people are in favor of shortening up the period.

Mr. VAN GORKOM. Yes; and we talked about that, too. When the inflation goes up ordinarily 3 to 5 percent a year, once a year probably is adequate. But when it goes up 12 percent a year, Mr. Danstedt says people he represents found this very painful and about the middle of the year already were in trouble.

Mr. JACOBS. I feel very strongly about the earnings limitation either being eliminated or substantially increased, and I was wondering in line with one of your suggestions about increasing the retirement age, would that be something at the very nub of those two concepts?

Mr. VAN GORKOM. Well, increasing retirement age, of course, could certainly reduce the cost of the system after 2005, but frankly we didn't discuss it. In fact, we mentioned that Congress should consider it after the year 2005 and the newspapers promptly blasted us out of our seats. It is very unpopular today because everyone wants to reduce the retirement age today and all the pressures, particularly from organized labor are very heavily in that direction. But any increase in retirement age would definitely reduce costs and reduce them substantially.

Mr. JACOBS. What I had reference to was increasing retirement age and doing away with the earnings limitation.

Mr. VAN GORKOM. With the retirement test?

Mr. JACOBS. Yes, right.

Mr. VAN GORKOM. Well, in a matter of a few hours the people at Social Security Administration can give you the relative costs of those two tradeoffs to see if they balance out.

Mr. DANSTEDT. If it increased in 1972 you have no problem.

Mr. JACOBS. I know that the \$4 billion cost of the system, if you eliminate the earnings test, is that the net or the gross, that cost to the trust fund, because that would be offset, the earnings would be.

Mr. VAN GORKOM. Yes.

Mr. JACOBS. They would be paying social security taxes in.

Mr. VAN GORKOM. We made a great effort to try and figure out what that offset was, but the one economist who was assigned that task ended up with the conclusion—you can bear me out, Henry—that there were no hard facts about it. What he could get by analogy, all the data he could find, and as much reason he could apply to it, he concluded that probably the offset was quite small.

Mr. SMITH. Incidentally, I have a different recollection from my colleagues here.

There was a \$4 billion figure quoted for elimination of the means test, work test. I believe there was a subsequent calculation which ended up nearer \$6 billion. I think you may want to question your social security people.

Mr. CONABLE. If the gentleman will yield, I think you probably know the political considerations back of our having failed to move the earned income limitation up in the past. It always comes down to a costing so much money to do it, and we have to decide whether to give that degree of benefit to the 31 million people who are drawing and not working, or to the million people who are working and not drawing. And we usually decide that the greater dependence is on the side of those who are not working. And therefore, we give the benefits to those who are not working, rather than those who can.

And it is a dilemma that we have never been able to resolve. We would like to move up the earned income ceiling, but in a closed end system, obviously, it is going to cost money, and that means, if you spend money on that, you can't spend it on an across-the-board benefit increase or on other types of reform that obviously are needed in the system.

Mr. WALLIS. What we should consider as your colleague on this side of the table pointed out is the increase in national income if those people work, which, in turn, would yield some money to the Treasury. Social security people are not much interested in that kind of a counter-balance, though, because it doesn't go to social security. It goes into the general fund.

Mr. CONABLE. We were able to get into the law some modest addition to benefits for every year worked after age 65. Now, that was a pretty small compromise to make on this.

Mr. WALLIS. Well, it is a little more than that.

Mr. CONABLE. But there was some very modest advantage resulting from additional contributions beyond age 65 that taxpayers may make.

Mr. JACOBS. One last question.

Mr. Van Gorkom, are you suggesting that medicare ought to be scrapped and absorbed into a national health program?

Mr. VAN GORKOM. Well, the majority of the Council felt that that would be an actual result of the establishment of a national health insurance program. Of course, we are not authorities in that field, nor did we have—but we figured that regardless of what we thought, if a national health plan were adopted, the medicare plan would be absorbed into it.

Mr. JACOBS. Thank you, Mr. Chairman.

Mr. VAN GORKOM. That could be an erroneous assumption, of course.

Mr. CONABLE. Mr. Chairman, I wonder if the gentleman from Arkansas might not be invited to approach the table.

I have a feeling he may know more about social security than anybody else present.

Mr. BURKE. He does know more than anybody else.

Mr. MILLS. I am just observing.

Mr. BURKE. I had invited him up.

Mr. Archer is recognized.

Mr. ARCHER. I am intrigued by your recommendation on medicare funding out of general revenue, from two standpoints.

No. 1, forgetting about national health insurance because it may well require a payroll tax in excess of that presently in place and therefore you are not going to have any money left to go back into OASDI without raising taxes; are you suggesting that medicare be folded into medicaid?

Mr. SMITH. In effect, I think that is the recommendation.

Mr. DANSTEDT. That is from some trustees.

Mr. ARCHER. So, you are willing to accept the needs test as it relates to medicare?

Mr. SMITH. Mr. Chairman, I would like to be recorded here and elsewhere as opposed to that notion, and I think that is a mistake.

Mr. DANSTEDT. I am recorded that way, also.

Mr. ARCHER. Well, but the other two gentlemen are the ones who really feel strongly, Mr. Van Gorkom and Chancellor Wallis, and I would like to get your comments with respect to this.

Mr. WALLIS. Well, I don't think we have much comment on that. That is, we took the line that medicare benefits are not related to earnings, and for that reason ought not to be financed by an earnings rate tax. But we did not consider whether it should be financed out of the general revenues, or should be financed out of general health insurance, if there is such a thing, or should be made identical to medicaid, or should have a needs test applied to it.

Mr. ARCHER. Well, how can you prevent that; though, under the very same logic Mr. Van Gorkom has made, I think effectively, that we should not have general revenue going into OASDI? How can you escape a needs test once you have gone to general revenue?

Mr. VAN GORKOM. I personally feel—we did not discuss in the council, but I personally feel if you finance medicare from general revenues you very well may end up with a needs test for the reasons I gave on OASDI. You want to do the most for the people who need it the most, and you want to do it at the least cost, and if it is a system taken from general revenues the taxpayers who supply those general revenues through their representatives will in essence say we don't mind supplying it, but supply it to the people who need it.

So, I think there is very definite risk if medicare is financed from general revenues, it will end up with a needs test.

Mr. ARCHER. But you think that is a lesser of evils when you weigh all the problems and difficulties?

Mr. VAN GORKOM. Well, we asked ourselves the question, why is medicare under social security at all?

Mr. STEIGER. There is a very simple answer.

Mr. CONABLE. Jurisdiction, again.

Mr. VAN GORKOM. OK. But I mean medicare is a totally different system than OASDI and they just happen to involve in some instances people over 65; they have that in common.

Mr. ARCHER. All right. Now, having made that recommendation, what tax would you levy to produce the general revenue?

Mr. VAN GORKOM. Well, that, of course, I don't know. What tax would you levy if you use general revenues in social security, I can't say.

Mr. ARCHER. Well, that is the same question.

Mr. VAN GORKOM. Well, I think it is important, because we obviously recognize that if you use general revenues as a substitute for medicare, for some people are just going to shift from one tax to another, or a great many will. The only people who really benefit are those at the bottom of the totem pole who would not be paying income taxes.

Mr. ARCHER. But you have to assume raising tax.

Mr. VAN GORKOM. Of course.

Mr. BURKE. I would like to make an observation at this point. If you keep bringing up this subject of general revenue, you might make it so attractive that it might go through this year.

Mr. ARCHER. Mr. Chairman, if we are sure we put a tax on it at the same time to produce that general revenue, it might not go through as fast as you think.

Mr. VAN GORKOM. That is why our basic recommendation for social security and OASDI is raising the wage tax, because the revenue is related to the tax. General revenues don't come from a few, they come from all of us. They don't just appear from Mars or somewhere.

Mr. ARCHER. Then would all of you be in agreement, that if we go to general revenue that we would also have the responsibility of placing a general tax to provide that money?

Mr. DANSTEDT. Sure.

Mr. ARCHER. Rather than merely adding on to the deficit?

Mr. WALLIS. We all agree to that, but that wasn't the kind of question the council dealt with.

Mr. ARCHER. All right. Now, let me, if I may, and maybe we have talked too long about this aspect of it, but I do think it is important to talk a little bit more about the general concept of relating the pay-

ments to the benefits. And you touched briefly on the fact that the minimum benefits do not actually relate to the premium that is paid in.

Would you feel that it would be proper for our committee to investigate those portions of social security today, where the minimum benefit is perhaps one of the outstanding examples, that are in effect welfare and do not relate to the money that is paid in and then shift those portions over to general revenue?

Mr. VAN GORKOM. Well, it goes beyond the minimum benefit. The benefit structure itself, as you know, starts out by paying 120 percent on the first \$110 of your average wage, with the next bracket, \$290, paid at 47 percent. That is a tremendous discrepancy. We assumed it was induced purposefully, because they wanted to favor the low-paid people—to provide as much as possible. In other words, to tilt the benefit scale, or the benefit, to be sure there was some reasonable minimum they would get.

Now, the Council did take some action in this regard, because it now feels that with SSI in existence this is not as necessary as it was before.

We did vote, for example, to limit the benefit scale to a maximum of 100 percent in any bracket. The reason being, we felt it just didn't seem right to be paying people more than they were making as a part of their benefit for a part of the total package. And the reason for their feeling in this area is that, with the introduction of such system as SSI, the original purpose of the minimum benefit and this heavy tilting is reduced, certainly.

Mr. WALLIS. Some of the necessity for the minimum benefit and the tilting would be eliminated if there were a proper automatic adjustment for inflation.

Now, some of the people come in with very low averages, and therefore, they qualify only for the minimum benefit. The reason may be that they made those earnings a long, long time ago, when wage rates were much lower, and they may really have been at about the average wage level for those days. And those numbers are what are recorded and averaged up 20 years later, say, and give a very low figure according to contemporary wage scales. They couldn't live on the benefit corresponding to those average earnings so you raise the minimum benefit.

Well, now we have proposed that in calculating monthly earnings, the earnings should be indexed. That is, if a person earned the money in 1952, if he earned \$1,000 in 1952, you should multiply that by the ratio of average earnings in 1975 to average earnings in 1952. Do the same for each year and average those indexed earnings as the basis for benefits.

If you did that, then, the fact that some people earned their money way back before inflation had gone as far would be allowed for and you wouldn't have so many people coming in that had benefits they couldn't live on, and wouldn't need an extra balloon at the lowest end.

Mr. ARCHER. Wouldn't that further, though, assist the category of people Mr. Van Gorkom mentioned, the Federal employees who might go out and work for a couple of years and then become employed by the Federal Government for, say, 25 years, and then come in and claim their benefits based on an increased value prior to the time that they became employed by the Federal Government?

Mr. CONABLE. I bet it usually works the other way around, though, that they work for the Federal Government first, and then go out and moonlight enough to get coverage under social security.

Mr. WALLIS. Indexing the wages would tend to make it indifferent whether you made your money early or late in life, or whether you qualified for social security before or after qualifying for a civil service pension.

Mr. ARCHER. That is right.

Mr. WALLIS. Then, after retirement, continue to allow for inflation by adjusting benefits according to the consumer price index. At present, for earnings prior to retirement no adjustment is made at all.

Mr. ARCHER. Well, if you index the earnings prior to retirement and you also index the benefits after retirement, doesn't that put you back into your double-dip or flaw situation?

Mr. WALLIS. No; it sounds that way but it is the opposite; it eliminates the double-dip.

Mr. VAN GORKOM. Of course, you understand when we recommended that you index the wages you also have to change the benefit formula because the indexed wages would be much higher, two or three times as high as the lifetime average, and therefore the formula must be different.

Mr. CONABLE. You get away from the 120-percent formula that is reasonable.

Mr. VAN GORKOM. Well, one example of the formula would be 100 percent of the first \$120 of average pay and then 31 percent for everything over that. That is just an example but that is an order of magnitude the way the formula would look. With indexed wages you would only have the two-tier system, 100 percent for the first \$120. That, again, is to give some reasonable minimum to everybody; you still have that problem. And then 31 percent for everything over that, and that kind of a formula would tend to approximate the benefits now being given under the more complex formula.

Mr. ARCHER. Doesn't that conflict, though, with your general philosophy of matter of right, and your benefits being related to the premium that you pay in?

Mr. VAN GORKOM. Yes; but as I said from the very beginning there never has been a direct relationship between what you pay out and what you get. For example, when we said before if you increase the wages covered from \$14,000 to \$24,000, everybody who got taxed on that \$24,000 would be getting a benefit of only 20 percent on that extra \$10,000. It has always been tilted very heavily at the bottom. And that, you know, that is just a change in philosophy, if you want to.

Mr. ARCHER. It always hasn't been the result of increases that have tilted it and initially it wasn't tilted.

Mr. VAN GORKOM. Yes; I think that.

Mr. ARCHER. When you say always, it really hasn't been always, has it?

Mr. VAN GORKOM. No; I would have to correct myself and say as far back as I checked it has always been heavily tilted. I didn't go back to the beginning.

I guess when it first came in, there were fairly flat benefits, but I wouldn't really know.

Mr. ARCHER. What would you feel about offering to certain self-employed groups a chance again to voluntarily exempt themselves from social security? We have a disproportionate draw on the fund from the self-employed groups in relation to the contribution to the fund, because they pay lower total, overall tax rates. If some of these groups would voluntarily elect to leave the coverage, it would benefit the fund. Would that not be a smart thing for us to consider?

Mr. VAN GORKOM. I can only say our general philosophy financial viewpoint is that universal coverage is the goal the Council endorsed. We think everybody should be covered. When you let people exempt themselves, only those people who will lose will opt out. And people who gain and are a bigger drain on the Treasury would remain in.

Now, your point posed another question, though. From the very beginning the self-employed have only paid a tax that was supposed to be one and a half times what the employee's tax was. That was a philosophical decision. I assume it could be questioned from the viewpoint of finance, because the costs of supporting such a person are just as high as it is to support a wage earner who was employed, and his employer pays just just as much as the employee.

But beyond that, the Congress has frozen the tax of the self-employed, so it isn't even as high as it should be under the original law, and we have recommended that that should be changed; it should go up.

Mr. ARCHER. Oh, you are recommending that it be equal to the combination of employer-employee contribution?

Mr. VAN GORKOM. No; we did not pass on that. We did not take up that subject.

Mr. ARCHER. As long as it is not equal.

Mr. VAN GORKOM. It is a drain.

Mr. ARCHER. And imposes a bigger drain on the system than the funds coming in relative to the other members of the system. It seems to me that it would be advantageous to the fund, particularly with the financial difficulties that we see ahead, to let these people exempt themselves. There is no way you are going to make money off of any of the self-employed groups that are in the fund.

Mr. VAN GORKOM. Not at $1\frac{1}{2}$ times—that is right. I assume, again, that it is like the tilting of the benefit schedule. Apparently, Congress wanted to give some benefit to the self-employed.

Mr. SMITH. There was another point involved originally, I think, and that is, the income tax on the total contribution by the self-employed. The self-employed pay whatever they pay after taxes, whereas the employee pays after tax on $\frac{1}{10}$ ths on half of it and the employer gets—

Mr. ARCHER. But that doesn't help the viability of the social security fund.

Mr. SMITH. No; it was put there, I think, as equity to the individual. The individual self-employed has to pay a total after tax, whereas the individual who is employed pays a total, pays his part after tax but the employer part is paid before tax. The individual who is self-employed is both an employer and employee, and in order to equalize the net tax, they had a reduced rate—

Mr. VAN GORKOM. As he says, that is the rationale, but you are correct—that doesn't help the social security system.

Mr. CONABLE. It's not good rationale from an economic viewpoint, either, because the employer gets the deduction of the contribution to the social security tax that he pays in, and he can make a classic economic argument that the employee pays the employer's share as well in the sense that it reduces the demand for his labor to the extent the employer has to pay it.

Mr. WALLIS. Most economists think the incidence of the employer's tax is really on the employee, by reducing what the employer will pay the employee, or influencing whether he hires the employee at all.

Mr. ARCHER. Let me ask you one question that goes back to your original statement, Chancellor Wallis, and that is, about an independent audit or review which I think has a lot of merit to it. Do you think this could be done by the GAO?

Mr. WALLIS. No; I think it needs to be done by a completely outside organization that is experienced in this kind of research, and I would hope that it would be done by an organization that isn't keeping its eye on what the policy implications of its findings are; just simply find facts and information about how the system works and let the chips fall where they may. Then some latter advisory council will have to worry about the policy implications.

Mr. JONES. Will the gentleman yield?

Mr. ARCHER. I will be glad to yield.

Mr. JONES. Who?

Mr. WALLIS. What is that?

Mr. JONES. Who?

Mr. WALLIS. The next advisory council.

Mr. JONES. No; who is this disinterested group you are talking about?

Mr. WALLIS. Oh, I don't know exactly. The agency that did the Russian study I mentioned earlier was National Bureau of Economic Research. That is a private institution which is the source of practically all the factual information we have on the economy—national income, gross national product, productivity, money supply, financial flows—almost anything you can name. But I don't know if they would do a thing like this.

Mr. BURKE. I promised to recognize Mr. Pickle.

Mr. PICKLE. Thank you, Mr. Chairman. I have a meeting at 3. I would like to ask a question or two, right quick.

Let me ask you, do you have any members of the council who are under 65 years of age?

Mr. VAN GORKOM. I started well below 65.

Mr. PICKLE. Do you have anybody that is 25 or 30 years old on the council?

Mr. DANSTEDT. No.

Mr. PICKLE. Do you have any women?

Mr. SMITH. Yes.

Mr. DANSTEDT. Two women. We don't know their ages.

Mr. PICKLE. We are reaching the point where the attitude of the young makes as much difference as that of the old; so we ought to have a spread. I think it ought to be considered.

In an effort to try to reduce some of these expenditures through decoupling, have you made a study to show how the various groups

might benefit; that is, whether it is low income or higher income, minority, or any particular group who would be benefited?

Mr. WALLIS. Let me say a word about decoupling and then Mr. Van Gorkom can expand. The purpose of decoupling is not to lower expenditures, and as proposed we would expect it to keep expenditures just exactly where they are now, unless Congress deliberately decides to change them, and benefits for any given individual would be essentially the same as now. There might be some minor shifts but nobody needs to lose.

Mr. PICKLE. Just keep it?

Mr. WALLIS. At present, the ratio of benefits to earnings before retirement is completely out of control. Congress always has controlled that replacement ratio, but the automatic adjustment for inflation—which was basically a good idea—has a flaw. Our recommendation for correcting the flaw is not intended to change anything else in the system either for the better or the worse, simply to eliminate the flaw.

Mr. PICKLE. I had the clear impression this was to try to make some savings of benefit. That is true of those people who are actually in the work force, isn't it—those who actually retire?

Mr. VAN GORKOM. No. Let me give you a brief illustration:

A person retires and is going to get \$180 benefit per month. That is 60 percent inflation ratio. A very important criterion how this system works replacing wages is assuming wages go up 5 percent and never change. If the inflation rate is 2 percent at the end of about 40 or 50 years with 60 percent inflation, it gets down to only 45 percent; on the other hand, if inflation goes to 4 percent in 50 years, that replacement ratio will be 165 percent, which means he is going to get 1.6 times as much as he was making before he quit. So this wide swing from 60 down to 45 or up to 165 is all the result of what happens to wages and prices over which none of us has any control. And the whole purpose of this is not to save money but to freeze replacement; give Congress ability to control the replacement ratio.

Mr. PICKLE. I think the average is exceeding.

Mr. VAN GORKOM. Let me be completely honest and say to you on the basis of forecasted increase in wages and prices that the trustees have forecasted the cost after about 40 or 50 years will be substantially higher if we don't decouple than if we do. The reason for that, we will create replacement ratios in the future which are unreasonable.

Mr. PICKLE. All right.

And another question, are you able to program in your long-range projection the possibility that as people live longer and as fewer people may be entering into the work force, that more people may choose to keep on working, rather than to draw benefits? Is that so, and would that be material?

Mr. VAN GORKOM. Well, that was the reason, that would be very material if people work after 65 and did not draw benefits, then that was our recommendation that they consider.

Mr. PICKLE. My question to you, do you think that might happen? If so, what might it mean to the system?

Mr. SMITH. The estimates we have do not indicate it would have a significant impact.

Mr. PICKLE. All right. Now with respect to your recommendations, you come forward divided; the trustees say one thing and you another, and you as a group are about as cut up as a boardinghouse pie.

With respect to tax, how much would you say it would have to increase? You said a small amount; do you have a sum?

Mr. SMITH. Yes; I recommended it be raised 0.5 percent for employees and 0.5 percent for employers.

Mr. VAN GORKOM. That was the recommendation of the council.

Mr. PICKLE. Of the majority?

Mr. DANSTEDT. A minority don't agree with that.

Mr. PICKLE. I understand you are a minority. In your case, then, how much would you raise the base, if we went your amount?

Mr. DANSTEDT. The recommendation I made was \$24,000 fairly shortly, maybe 1977; over the next few years move up to \$28,000.

Mr. PICKLE. Now, did you give any consideration to a combination?

Mr. VAN GORKOM. We didn't; obviously, you can. I should add one thing about what Mr. Danstedt said.

Mr. PICKLE. Do you have something to say for that?

Mr. VAN GORKOM. Well, this \$14,000 goes up every year anyway, and as average wages go up the \$14,000 goes up and by 1977 it is estimated to be \$19,000 anyway.

Mr. PICKLE. I would assume I am talking about old age-survivors under the law now.

Mr. VAN GORKOM. You say about \$10,000 increase over what would be in the normal flow.

Mr. PICKLE. Now, part of our problem stems from two factors: one, the economic conditions we find ourselves in, and another reason which I will come to. But first, if we were to have another embargo or a long continuation of our unemployment, or the same economic conditions which developed a short time ago, what kind of cushion do we use to save the system? We are getting on borderline and have got to have some reserve. It is almost just about breaking even, really.

Now, what are we going to do if we have another embargo and another crisis hits? Have you got any recommendation for that?

Mr. VAN GORKOM. Well, just to see what we can do. In 1974 the system did break even, in fact added to its reserves; this year it is scheduled to lose \$3 billion or \$4 billion—\$3 billion or \$4 billion in OASDI. It is estimated that you could do nothing for 3 years and the system would still be perfectly capable of meeting all its obligations.

So you can't say the system is going to be broke if you don't do something this year. This year we recognize high unemployment and recession. Next year is election year and if you waited to 1977 and you made an increase of 1.1 percent, you would probably be all right.

Mr. PICKLE. Within the last 2 years, roughly, what has the economic condition cost this fund?

Mr. VAN GORKOM. Well, the last 2 years—well, it didn't cost anything last year. As I said, the fund actually increased last year. This year the reduction will be about \$4 billion, give or take \$1 billion. Next year it will be off some more, I don't know exactly \$6 or \$7 billion, and it is estimated that if nothing is done by 1980 or 1981 under current projections, the fund will be exhausted.

Mr. PICKLE. Well, some gentlemen who testified before us and some of you maybe in your testimony have indicated that we ought not to be alarmed, that this is a fairly unusual situation and heavy drain. Now, I am trying to say—well, if there is another heavy drain, another embargo, how much really is saved here; how much security do we have if we do not do something quickly?

Mr. VAN GORKOM. Well, you don't need an embargo. Under current projections without an embargo the fund is going to be exhausted by 1981.

Mr. PICKLE. I am saying suppose in 1976, suppose we get like we did—another embargo. Then we have a problem, don't we?

Mr. VAN GORKOM. We only have a problem if the total amount, if you have wide-scale unemployment, I mean a bigger problem than you have already. Do you think the embargo would increase the total for unemployment drastically?

Mr. PICKLE. I do.

Mr. BURKE. Would you yield at that point?

Don't you think that we would be playing brinksmanship with this fund if we allow ourselves to wait until 1977?

Mr. VAN GORKOM. Mr. Chairman, I have tried to divorce myself personally from this discussion. If you want my personal opinion, you should increase the tax 1 percent right now. But I recognize that we live within the limits of political possibility. And I am saying that if you don't, you have the leeway created by this fund which will permit you to take no action for 2 years, if that is what you want to do.

I quite agree with you; I think that is a form of brinksmanship. I don't think it is psychologically unsound, because the great mass of workers being uninformed are concerned about this. They are being told by the papers all the time the fund is broke, and when someone can say concretely that the fund went down this year by \$3 billion, that is going to concern them.

I think we spent a lot of time in the Council talking about what should this fund be. The Council before us said this fund ought to be equal to 1 year's outgo. As an average, that means somewhere around \$67 billion. There is nothing sacred in that figure, and we thrashed around with it, but I personally feel that the fund should be maintained at some reasonable amount, which would permit it to go through 3 or 4 years of low income, a recession-type of economy, and still provide for these ups and downs. It doesn't have to be 100 percent of 1 year's outgo, but I certainly think it ought to be between 60 to 100 percent just to serve its purpose as a surge tank, because the funds don't go in and out evenly. So my personal opinion is no, you should not let this fund run itself down; you should try to maintain it at some reasonable amount, and that is one of the subjects that Mr. Wallis has said this group should look at—what is a reasonable amount for that fund to maintain itself at.

Mr. WALLIS. One thing needs to be kept in mind about that fund, the main thing, really one Government agency gave another Government agency.

Mr. BURKE. There was some use of that fund over the years and it is getting more of interest to me every year.

Mr. Crane.

Mr. CRANE. I was intrigued by Mr. Van Gorkom's proposal of increasing the age limit for receipt of the benefits, only because when we indexed the increase in benefits we overlooked, I think, another indexing proposal and that was increasing that time for receiving benefits as the life-span increases. My recollection is that the average life span was 62 in 1935. Since people didn't receive benefits until 65, I assume most people died before they got them. It is up to about

71 now, and I think you could resolve all of these problems if you would deny benefits until age 100. But, seriously, it does seem to me that some kind of indexing proposal at the inception of the program might have been in order.

I would like to ask a couple of questions. First of all, Mr. Van Gorkom, I think, testified that many people—and correct me if I am wrong—if not most, have lost sight of the fact that social security was initially intended to be only one part of the wage replacement system, and to the extent that is so there is a growing pressure, particularly from policemen and firemen because I have been solicited by them on this issue, to opt out of the system. I think they, too, view social security as a total retirement package, and they have what they see as a superior retirement program which costs less, better benefits, and so they want out.

Mr. VAN GORKOM. May I interrupt you for a moment?

Mr. CRANE. Surely.

Mr. VAN GORKOM. They have another reason for opting out, and this has concerned us. Whole government systems want to opt out so that they can get their better system, because not being covered by social security, and later get into Social Security also.

Mr. DANSTEDT. Another job.

Mr. CRANE. Well, let me ask this question: Excluding that second motivation they have, if you take a 21-year-old policeman or fireman who looks at comparable programs and says I think we have a better program here, costs less, and benefits are better, would it be less injurious to the system to let people out like that, opt out?

Mr. VAN GORKOM. As a general philosophy, it was the council's view as a matter of fact, we should move as rapidly as possible towards universal coverage that is best for the system.

Mr. DANSTEDT. Moving in Federal employees.

Mr. CRANE. Well, the biggest group that is out is Federal employees.

Mr. VAN GORKOM. We want Federal employees included, but I would have to say in all honesty that in projecting the cost of the system for the future we did not assume that Federal employees would be covered because we think politically it is a dead duck.

Mr. CRANE. That would be my next question. 2.8 million employees, ourselves included, have chosen apparently an inferior program because we are willing to suffer, but it just seems to me that we ought to be in on this great program, too. And if it is not proper to let others opt out that way because it would be injurious to the program, then logic would dictate that we fold the 2.8 million of us who work for the Federal Government into the program.

Mr. WALLIS. Most of them will be in both. That is why they don't want social security to cover Government employment. They work for the Government and get a Civil Service pension, then work in employment covered by social security and get that too.

Mr. VAN GORKOM. Well, the Government plan is better than social security.

Mr. CRANE. I know it is. I was being facetious.

Mr. VAN GORKOM. OK.

Mr. CRANE. But I think we ought to be in a position in the Congress having a chance to vote on benefits and also taxes, to participate in

payment of the taxes. There is mounting bitterness by young wage earners over the Social Security tax bite, which is a regressive form of taxation inasmuch as there are many millions of wage earners who do not pay any Federal income tax, but pay mounting Social Security taxes. I think everyone clearly recognizes the injustice of the system. Someone clipping coupons earning \$100,000 a year draws his full benefits while another fellow trying to supplement his earnings by working is penalized. Maybe we ought to set up a means test to treat this like any other social program and fund through general revenues.

Wouldn't that relieve the headaches?

Mr. VAN GORKOM. I am glad to see you recognize there would be a total change in the system.

Mr. CRANE. Well, I think the system is unsound because of the injustices.

Mr. VAN GORKOM. Well, let's start with the regressivity. The tax is regressive in that it is the same regardless of your income, but the benefits are very progressive, which offsets the regressive character of the tax.

I can show you—don't want to take the time with an example—that the man who makes the maximum gets a 30 percent wage replacement; the man who makes the minimum gets 60 percent of his wage replaced, and the tax they pay is based on their respective wage, so the man down below is getting twice as much benefit as the other. The regressivity is more apparent than real.

Mr. CRANE. Wouldn't you concede that to a struggling young couple with maybe two or three dependents, who are making the median income today are put in a position of more suffering than offset benefits when they reach 65, assuming they live that long?

Mr. VAN GORKOM. Studies have shown that as far as benefits can be compared, the benefits of a privately insured plan can't match social security benefits.

Mr. DANSTEDT. Not only that, but couples with children are covered by survivors' benefits.

Mr. CRANE. Well, yes, except I was thinking of the fellow who is just trying to make ends meet today, and that is what I hear from increasing numbers of young people who are very bitter about it. It seems to me that we have a steadily reducing tax base while the beneficiaries increase. It's an inverted pyramid with the apex being the tax base and the base being the beneficiaries. I just can't imagine what kind of taxes we will have to levy at that time.

Mr. VAN GORKOM. The taxes will be very high unless you increase the retirement age, or did something like that, which of course you can do.

Mr. WALLIS. Approximately 50 percent higher, because there will be 45 retired people to be supported by every 100 workers instead of 30, as now.

Mr. CRANE. Doesn't it make a lot of sense to reevaluate all of the premises behind the program?

Mr. VAN GORKOM. We always think of social security in terms of when people retire. The benefits the young people get in their protection against disability are enormous. There is no way they could get a policy that would cover them on that basis from any private insurance firm. The young man has a very generous package. He gets far more than his dollar really should buy in that sense.

If you sat down today to devise a new system, you would say, first of all, of course, that for those people who have nothing, we are going to have to take care of them. So we have to have some kind of a needs tested program. On the other hand, since there are insurance companies who sell retirement policies, there is nothing wrong with a contributory plan, and that is OASDI. Especially the people at the low end of the totem pole get more than their real dollar's worth for what they pay in. So it is a very sound plan for them.

In addition, you don't want either of these parts of the program to reduce the incentive to save money. If you start saying we are going to reduce the benefits because you have other income, then the guy is going to say, "Well, why should I save my money? I might as well go out and blow it because I know I will get social security. If I save my money, I won't get social security." So we will have a definite disincentive to save if it is structured the way you say. That is the reason people are often emotional about this.

But I think if you really analyze it, the system should take advantage of all possibilities to provide retirement benefits, forgetting disability for the moment. One is that there should be a straight contributory insurance plan like OASDI. It is heavily weighted toward the low-paid, but it is still a contributory plan. Second, you want to encourage savings. Third, for people who are really hard up and can't make it, there is always the needs program which will be available and should supplement the whole thing. But I think every one of these three pieces has a part to play that is important to the economy. The savings part should not be overlooked. That is where most of the capital of this country comes from.

Mr. CRANE. You mean private plans?

Mr. VAN GORKOM. Private plans. Some \$70 billion last year.

Mr. WALLIS. One of the members of the council filed a supplementary statement, making a similar assertion. Mrs. Campbell, on page 73 of the Council's report, says "During the several meetings of this council, I have felt that we are tinkering at the edges of what was originally, in 1935, a rather simple program," and so on. Her idea is that we have not gotten at the really fundamental issues.

Social security is an area to which very few researchers or economists or sociologists or political scientists have given much attention. It is only in the last couple of years that articles have begun to appear in the professional economic journals, by people like Feldstein at Harvard, for example, and others.

Mr. CRANE. The reason this thought comes to mind, of course, is because of Milton Friedman's negative income tax proposal where you eliminate social security and the whole grabbag of social programs and simply guarantee a certain level of existence to everyone. I don't think that is necessarily a disincentive to saving. Sure, there are some people that would say, "Heck, as soon as I can get out of working and being productive, I know I will be provided for."

On the other hand, it is a question of the level you would be providing. I don't think that most people would look forward with equanimity to the idea of being carried past 65, say, at the poverty line.

Mr. SMITH. That is one of the advantages of the present plan. By having the benefits linked to wages, you do give the individual some assurance that his payments will be proportional to his living standard.

Any other plans on a needs test basis would certainly violate that very desirable psychological and practical principle.

Mr. VAN GORKOM. I do agree with the basic attitude that ties in with the recommendation of the council that Mr. Wallis has spoken of. That is this need for a study. As far as I know, Congress has never really addressed itself or anybody to the question of what is a proper replacement ratio.

The reason is very simple. Up until now our limitations on replacement ratio have been the financial ability of the system. We need to know what replacement ratio it can afford. What can it produce as a contributory system? Then somebody has to decide if that is adequate and if it isn't, have separate systems built up alongside of it. But this kind of basic work has never really been done.

Mr. CRANE. That is what you are generally recommending should be done by an independent nongovernmental commission. I would applaud that recommendation.

Thank you gentlemen. I yield back the balance of my time.

Mr. BURKE. During the Depression, the cost of living went down, didn't it?

Mr. SMITH. That is right.

Mr. VAN GORKOM. That is right; I will say it did. Unfortunately, so did our wages—faster.

Mr. WALLIS. During the 19th century, it fell for 30 years.

Mr. BURKE. If we follow the cycle of the last Depression, these projections which we have here certainly go out the window.

Mr. VAN GORKOM. About these projections, you must realize of course that nobody knows what is going to happen to the 4 and 6 percent for 75 years. But they assume that there will probably be sharp ups and downs and that wages will average 6 percent and prices will average 4 percent increase. They are only averages. There will be periods when they will be much higher and much lower. But these are only averages of course. The whole deficit and everything else is based on the validity of those assumptions. They could be wrong.

Mr. SMITH. The same thing is true of the demographic assumptions.

Mr. BURKE. If you recall real estate prices, homes costing about \$29,000 after 4 or 5 years of Depression went for \$6,000.

Mr. VAN GORKOM. That is right.

Mr. SMITH. Right.

Mr. BURKE. Food prices dropped dramatically.

Mr. SMITH. But they came back up. If you take an average over that period of time plus time on the other side of it, you come up with figures in the 5 and 3 percent range.

Mr. BURKE. They didn't go back up until after World War II.

Mr. SMITH. It depends on what period of time you are taking. You can prove most anything you want in economics by choosing the period of time in which you compute your figures.

Mr. BURKE. I think the real problem is a short-term problem. I think this idea of doing a lot of crystal-gazing on this long-term thing is a very conjectural way of doing things. I think people enjoy doing that, and they should do it. It is nice to read about it and have this projection made. A lot of people would like to know what the world is going to be like in 75 years.

Do you think it is possible to return to the old system we had before this amendment on the cost of living was adopted? Every

time Congress granted an increase it provided the revenue to take care of the increase.

Mr. SMITH. I don't think you can return to the old system of forecasting if you are going to continue to have——

Mr. BURKE. I don't mean forecasting.

Mr. SMITH. I mean forecasting under the old system of determining the tax rate. So long as you are going to have the automatic features of increasing benefits, the two things are not compatible. If you wanted to go back to the ad hoc basis on benefits as well as on taxes, that would be perfectly appropriate.

Mr. BURKE. That would be better than the present system which got us into the dilemma in which we find ourselves.

Mr. SMITH. From the point of view of financing it would be far superior and far sounder.

Mr. BURKE. This term "decoupling" sounds very intriguing. But I don't think many people know what it means.

Mr. WALLIS. We avoided it.

Mr. BURKE. I would like to compliment the man who thought up the expression because it confuses everybody. Would you like to explain that for the record?

Mr. WALLIS. First I will say we avoided the use of that term in the report for the reason you indicate. I don't know how that particular word got chosen. But there is a kind of a double-barreled adjustment operating, sometimes people say a "double-dip" adjustment, in the present automatic adjustment.

The way it works is this. You start with people who have retired and just focus your attention on them and there is nothing wrong with the present system of automatic adjustments. As the consumer price index goes up their benefits go up. The benefit schedule is set in relation to average reported monthly earnings so as to provide adequate benefits and give adequate replacement ratios. The schedule goes up with the cost of living.

However, as time goes by, people come in who had been working while this inflation was going on and their earnings were inflated by the inflation. So when they come in they don't come in at the same point on the average monthly earning scale. They get the first dip by having inflation push their earnings up and the second dip comes because at those earnings the benefits have been pushed up too by the cost of living index.

The double dip comes from the fact that before they retire their average monthly earnings are rising from inflation, and so are the benefits that go with any level of earnings. After people retire, the benefits that are assigned to their average monthly earnings are assigned as if those were uninflated earnings.

I am saying that the automatic increase works all right as it is for those people who have already retired. But for those who retire in the future it will give them a double dip.

Mr. SMITH. The explanation is contained on page 106 of the Council's report, if you want to have that studied.

Mr. BURKE. I have been studying all the reports. That is all I have been doing. My wife has been complaining.

Mr. SMITH. It is terribly complex to explain. Being an actuary, I think so. I think this language on page 106 gives it as clearly as it can be made.

Mr. VAN GORKOM. What you have to say, Mr. Chairman, is that when prices go up wages go up. As far as the person who is retired, his benefits go up with the increase in prices. But the man who is still working, his benefits go up with wages as well as with prices and therefore his increase in benefits as a worker is coupled—that is where the phrase comes from—with the increase in the retired worker's benefit. And if you decouple the system you cut that off.

Mr. BURKE. You recommend a 1-percent tax, which is half a percent each on employer and employee. Did you ask any questions on how much revenue could be raised by raising the wage base from \$14,100 and how much it would take to raise the same amount of money that could be raised by a 1-percent increase?

Mr. VAN GORKOM. Yes. What that would do if you raised it to \$24,000 starting in January 1976 would cut the short-term deficit by about nine-tenths of 1 percent and it would cut the long-term deficit by about one-half of 1 percent.

The reason for the difference is that first you increase the taxes being paid in. But eventually the people that are paying the higher taxes tend to draw higher benefits later so there would be a very substantial savings at first if you were to increase it to \$24,000, reduced later. It would cut about nine-tenths of 1 percent of the short-term deficit.

Mr. BURKE. How much does the 1 percent cover?

Mr. VAN GORKOM. The deficit that is foreseen for the next 10 years is about 1 percent. This would cover almost all of it. But of course then the savings would start to diminish after you got past 10 years or so because then some of the people who would pay the higher taxes on the higher amount would start to retire. They would start to draw benefits. The overall long-term debt savings is one-half of 1 percent.

Mr. JONES. Would the Chairman yield?

Mr. BURKE. Yes.

Mr. JONES. Did you ask what the additional one-half of 1 percent increase impact would be on small business employers, particularly?

Mr. VAN GORKOM. No, we did not. I might add that I suppose your Committee is used to this. But there are people at Social Security, if you want to know: If we do this what will it cost and what will it save? They can supply it to you.

Mr. BURKE. We will ask it.

Mr. JONES. One thing that could be helpful to us is that based on your experience with Social Security if you could supply us with the names of the people who are particularly responsible it would be very helpful.

Mr. VAN GORKOM. This gentleman here is now the Chief Actuary of the Social Security System. He and the people in his department will be the ones to supply all of that because it is an actuarial computation almost every time.

Mr. BURKE. Who is that gentleman that is coming in from Harvard?

Mr. VAN GORKOM. Mr. Feldstein. Martin Feldstein.

Mr. SMITH. Tomorrow.

Mr. VAN GORKOM. He will be here tomorrow.

Mr. BURKE. He is coming in tomorrow.

Mr. WALLIS. May I introduce Mr. John Trout, who was executive secretary for the council and the person to whom we turned. He always knew who was the right person in Social Security to get any information that we wanted.

Mr. BURKE. Is there anyone else who had anything to do with helping you out and you would care to introduce for the record?

Mr. WALLIS. Not that I see.

Mr. VAN GORKOM. I might say as a matter of fact personally I found a high degree of dedication and a willingness to help us by the people in the Social Security Administration. They were very helpful to the council.

Mr. BURKE. I think they are helpful.

Of course, competing with all the statements that are being made in the papers, that is our problem. This hearing this afternoon wasn't too well covered by the press. It is only the alarming news that interests them.

Mr. VAN GORKOM. That is right. The Freedom of Information Act was a great problem for us. We had to make every session open to the public, including our subcommittee meetings, and we had to distribute every piece of paper we gave our members. If we had an idea kicking around and then decided to abandon it, it would still get all over the newspaper. It is hard to live in a fishbowl when you are dealing with a subject like this. But I guess that is the price of democracy.

Mr. BURKE. For the record, I want to say that I don't agree with your whole report. But I want to compliment all of you for the fine work and dedication you have given.

Mr. ARCHER. Mr. Chairman, might I ask one question at this point?

Mr. BURKE. Yes, Mr. Archer.

Mr. ARCHER. I certainly am in general agreement with your three-layer concept. But it troubles me that you take the philosophical position for the need of each of these three layers, basing your first argument on the social security being one of right not of need to be supplemented by SSI to take care of need with a needs test.

But then you turn right around and justify the welfare aspects of the social security system that pay benefits out that are not directly related to the premium paid in. It seems to me you have an inconsistency there.

I am wondering if one approach toward the solution of the problem in the fund today would not be to try to excize the welfare part of it and let it go over into an area supported by general revenue on a needs basis so we can look at the social security as truly being one paid in as a matter of right. This would mean a minimum benefit schedule would have to be changed. The subschedule would have to be changed. The disability schedule would have to be changed in some way or another.

I am wondering if you don't think it would be worth the while of this committee to go into an exhaustive study of the welfare provisions that are in the social security program today and try to find a way to take them out and let them go on a needs basis supported by general revenue.

Mr. WALLIS. I think it is something to be examined carefully. But let me say what I think. The only grounds for having a social insurance program, a Government program of this sort, is to use the coercive power of the Federal Government to force people to do things they wouldn't otherwise do. If we go to the move you are talking about, we might as well abolish the whole thing. The private insurance companies can handle it just fine if it is only going to be straight insurance. They

are good at that. If you are going to pay your own costs, and only get what you paid for, the Government doesn't have any role in it.

Mr. BURKE. The trouble is, a lot of people will end by being buried in Paupers' Field. They just wouldn't do anything.

Mr. WALLIS. There would still be a method of dealing with those who have need.

Mr. VAN GORKOM. I think what the chairman means is a lot of people wouldn't save and buy insurance policies.

Mr. WALLIS. If people who could save don't save, then they become a burden on the public. That is the argument for forcing them.

Mr. VAN GORKOM. You could have a straight insurance plan and have it administered by the Government so that people will be forced to save their money. If you leave it just to the private insurance company plans, it becomes voluntary.

Mr. ARCHER. I think it is a little bit away though from the basic premise philosophically you have set out, which is, I think, an appropriate definition of what we should try to achieve in your three-layer program. But when you come to implementation, you abandon it in varying degrees.

Mr. VAN GORKOM. Of course, we must work with this program where it is. We are not sitting down to design it from scratch.

Mr. ARCHER. But you have not made any recommendations I know of that would cause us to move back more toward putting the social security fund on a basis of right and letting these three layers interact the way that they should philosophically.

Mr. SMITH. I think we have accepted in this country a compromise system. There is no question but that from the very beginning it was a compromise system.

Unless we are going to get drastic and make many important changes, it will probably always be that way. The original purpose of the act—I looked this up—was expressed to be "to keep people in their older ages from slipping into poverty." That was the basis, the philosophy, of the act. That does not mean that you need to have a complete quid quo man-by-man income. It means a social insurance system. A social insurance system as practiced throughout the world has never been a completely equitable system, man by man, as private insurance is supposed to be. There has always been a compromise between social goals and social purposes and some degree of individual equity. You will find this throughout all social insurance systems in the world.

Mr. VAN GORKOM. As a matter of fact, even if we were to abolish the weighted system and made the benefit structure uniform for everybody, there would still be a heavy social element in it. It uses the current cost method of funding, which an insurance company couldn't do. That means that even if we operate on an equitable basis, the benefits we are going to get are going to be far more in relation to what we pay in taxes, because the effect of inflation is going to be completely covered by the next generation who pays for our benefits.

But what you say is correct. It is a compromise system, as Mr. Smith has described. We have accepted that compromise, I guess, and we are talking about degrees. That is perfectly true.

Mr. WALLIS. We certainly did not consider for a moment making radical changes in the whole system or scrapping it or anything of

that sort. That didn't seem to be a relevant question for a Council like this.

Mr. ARCHER. I don't know that moving back toward trying to have the benefit really as a matter of right as compared to the question of need is a wholesale revolutionary change in the program. We have got major problems in funding right now. We have got to look at a combination of different ways of getting at it.

It is simple to say, "Let us increase the tax on the employer and the employee and the percent." That is simple. But that is going to run into a lot of resistance. If we could cut that down to a quarter of a percent by doing some other things, then we might end up with a better solution. That is the only reason why I bring this up. We could maybe move in that direction without any sort of wholesale revolutionary change in the system.

Mr. VAN GORKOM. I suspect that is probably true, a combination of factors to solve the financial problem.

Mr. STEIGER. Mr. Chairman, could I ask one totally unrelated question?

Mr. BURKE. Surely, Mr. Steiger.

Mr. STEIGER. I was intrigued some time back when you were talking about contract need. The next council goes into place when, 1978?

Mr. WALLIS. 1977. It should report in 1978.

Mr. STEIGER. It goes in in 1977 and reports in 1978. Ought there to be a requirement that there should be an advisory council which is there all the time instead of just periodically?

Mr. WALLIS. My offhand reaction to that would be that it is best to do it on an intermittent basis. Once you set up a permanent bureaucracy it gets in a rut. This way you get completely new people in. They take a fresh look.

It isn't as though the Advisory Council is passing laws. If recommendations are a little erratic from one council to the next, the Ways and Means Committee and the Congress add some stability. I think there is some advantage in having totally fresh groups.

As a matter of fact this is the first council that was a totally fresh group. All the other councils have involved people who helped to write the social security bill in the first place and involved people who had been on previous councils. There was nobody on this council who helped to write the bill back in 1935. There was nobody who ever served on a council before.

I am sure there are some drawbacks to that because of us all starting out so ignorant of social security. I don't think that would have been quite as big a drawback if we had our full 23 months that a council is supposed to have, from the 1st of February 1 year until the end of December the next.

But I think for the most part the drawbacks are offset by the continuity you get from the staff of the committees of Congress and from the congressional committees themselves.

Mr. SMITH. And from the administration.

Mr. WALLIS. And from the Social Security Administration.

Mr. STEIGER. Who pays for the Council?

Mr. WALLIS. The law provides that it be the Social Security Administration.

Mr. VAN GORKOM. We are also permitted to hire outside specialists, which we did.

Mr. WALLIS. Social Security hired them for us.

Mr. VAN GORKOM. Does that go on their budget too?

Mr. WALLIS. Yes. Anybody we recommended, they hired.

Mr. STEIGER. Would it not make some sense at some point to provide the Council with an independent appropriation for purposes of hiring its own staff so that you don't have to rely on SSA?

Mr. WALLIS. Anybody we wanted to have, we got. They were put at the disposal of the Council. In one instance they were able to get somebody from another Government agency for us, which we would not have been able to do without social security arranging it. So while in theory I recognize the validity of your point, I would say that in fact in no way did working through social security tie our hands. They seemed to bend over backward to avoid biasing us. We had a hard time finding out their point of view sometimes.

Mr. STEIGER. Thank you, Mr. Chairman.

Mr. BURKE. Without objection at this point House Document No. 94-75, "Report of the Quadrennial Advisory Council on Social Security," will be included in the record. With no objection, it is so ordered.

[House Document 94-75 follows:]

REPORTS OF THE QUADRENNIAL ADVISORY
COUNCIL ON SOCIAL SECURITY

COMMUNICATION

FROM

SECRETARY OF HEALTH, EDUCATION,
AND WELFARE

TRANSMITTING

THE REPORTS OF THE QUADRENNIAL ADVISORY COUNCIL
ON SOCIAL SECURITY, PURSUANT TO SECTION 706(d) OF
THE SOCIAL SECURITY ACT, AS AMENDED



MARCH 10, 1975.—To the Committee on Ways and Means and ordered
to be printed with illustrations

U.S. GOVERNMENT PRINTING OFFICE

48-648 O

WASHINGTON : 1975

LETTER OF TRANSMITTAL

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE,
Washington, D.C., March 7, 1975.

HON. CARL ALBERT,
Speaker of the House of Representatives,
Washington, D.C.

DEAR MR. SPEAKER: The 1975 Advisory Council on Social Security, appointed pursuant to section 706 of the Social Security Act, has completed its study of the social security program. In accordance with the law, the Council reviewed the status of the social security trust funds in relation to the long-term commitments of the social security program, the scope of coverage, the adequacy of benefits, and other aspects of the program.

As required by the law, the Council has submitted reports of its findings and recommendations to me, and I am herewith transmitting the reports to you. I have also sent the reports to the President of the Senate.

Sincerely,

CASPAR W. WEINBERGER,
Secretary.

Enclosure.

(III)

REPORTS OF THE ADVISORY COUNCIL ON
SOCIAL SECURITY

Washington 1975

(v)

CONTENTS

	Page
Letter of submittal.....	ix
Foreword.....	xi
Membership of Council.....	xii
Summary of major findings and recommendations.....	xv
I. Report on cash benefits program.....	1
Chapter 1. Introduction.....	3
Chapter 2. Purpose and principles of Social Security.....	7
Section 1. Historical development.....	7
Section 2. Adherence to fundamental principles.....	8
Section 3. Preservation of a tripartite system of income protection.....	9
Section 4. Social adequacy and individual equity.....	10
Chapter 3. Inflation and Social Security.....	13
Section 1. Summary.....	13
Section 2. Indexing earnings.....	14
2.1 Earnings and inflation.....	14
2.2 Stability of replacement ratios.....	14
2.3 Some considerations of equity.....	15
Section 3. Relating benefits to indexed earnings.....	16
Chapter 4. The retirement test.....	21
Section 1. Present law.....	21
Section 2. Basic purpose.....	21
Section 3. Liberalize provisions of the retirement test.....	22
Section 4. Eliminate monthly measure of retirement.....	23
Section 5. Upper age limit for the retirement test.....	24
Section 6. Taxes on earnings after age 65.....	24
Chapter 5. Treatment of men and women under Social Security.....	25
Section 1. Background.....	25
1.1 Pending Equal Rights Amendment to the Con- stitution.....	25
1.2 Court actions.....	25
1.3 Socioeconomic changes.....	26
1.4 Council considerations.....	26
Section 2. Equal rights for men and women.....	26
2.1 Dependency requirements.....	27
2.2 Benefits for fathers.....	28
2.3 Benefits for divorced men.....	28
2.4 Alternatives considered.....	29
2.5 Benefit eligibility and benefit computation.....	29
Section 3. Social security provisions that do not differentiate on the basis of sex.....	30
3.1 Benefits for working married couples.....	30
3.2 Imputed earnings for homemaker services.....	31
3.3 Special minimum benefit.....	31
Section 4. Other findings.....	32
Chapter 6. Other cash benefit recommendations.....	33
Section 1. Universal, compulsory coverage.....	33
1.1 Background.....	33
1.2 Problems under present law.....	33
1.3 Recommendations.....	35
Section 2. The minimum benefit.....	36
2.1 Present law.....	36
2.2 Issues.....	36
2.3 Alternatives considered.....	37
2.4 Effects of recommendation.....	37
2.5 Related changes needed.....	38

VIII

Chapter 6. Other cash benefit recommendations—Continued	Page
Section 3. Older disabled workers.....	38
3.1 Present law.....	38
3.2 Issues.....	38
3.3 Effect of recommendation.....	39
3.4 Alternatives considered.....	39
3.5 Cost and number affected.....	40
3.6 Other considerations.....	40
Section 4. Effect of social security on minority groups.....	40
Section 5. Program simplification.....	41
5.1 Background and discussion.....	41
5.2 Conclusion.....	42
Section 6. Frequency of cost-of-living adjustments in social security cash benefits.....	43
Chapter 7. Financing.....	45
Section 1. Basic characteristics of old age, survivors, and disability insurance program.....	45
1.1 Current cost financing.....	45
1.2 Measuring long-range costs.....	46
1.3 OASDI tax rates.....	46
1.4 Weighted benefit structure.....	46
Section 2. Automatic adjustment to inflation.....	47
2.1 Benefits.....	47
2.2 Taxes.....	47
2.3 Effect of wage and price increases on cost estimates.....	47
Section 3. 1974 Trustees' report on the financial condition of OASDI.....	47
3.1 Assumptions.....	47
3.2 Estimated deficit.....	48
3.3 Pattern of the deficit.....	48
3.4 Appraisal of assumptions used in the trustees' report.....	50
3.5 Revisions of the estimate of the deficit.....	50
Section 4. Council recommendations affecting financing.....	51
4.1 Stabilization of replacement ratios.....	51
4.2 Other benefit recommendations.....	54
4.3 OASDI tax rates for the selfemployed.....	54
4.4 Shift of medicare contribution rate to OASDI.....	55
4.5 Summary of effect of council's recommendations.....	56
Section 5. Meeting the estimated deficit.....	57
5.1 Short term deficit.....	59
5.2 Long term deficit.....	59
5.3 Proposed tax rates.....	59
Section 6. Other financing proposals considered.....	60
6.1 General revenue financing of OASDI.....	61
6.2 Raising the maximum covered wage.....	62
6.3 Increasing the retirement age.....	62
II. Report on medicare program.....	65
Statements of council members:	
1. Statement of Mr. Arnold, Mr. Cleary, and Mrs. Norwood.....	68
2. Statement of Mr. Byrnes, Mr. Danstedt, and Mr. Faulkner.....	71
3. Statement of Mr. Byrnes, Mr. Faulkner, Mr. Scanlon, and Mr. Smith.....	72
4. Statement of Mrs. Campbell, Mr. Faulkner, Mr. Scanlon, and Mr. Smith.....	72
5. Statement of Mrs. Campbell.....	73
6. Statement of Mr. Danstedt.....	80
Appendix A. Report of the Subcommittee on Financing.....	89
Supplement to Appendix A. Report of actuaries and economists.....	124
Addendum to report of actuaries and economists: Decoupling of OASDI system.....	128
Appendix B. Report of the Subcommittee on Treatment of Men and Women (with respect to sex and marital status).....	133
Appendix C. Statutory authority for the Advisory Council on Social Security.....	153
Appendix D. Findings and recommendations of previous advisory councils on Social Security.....	154
Glossary.....	178

LETTER OF SUBMITTAL

THE UNIVERSITY OF ROCHESTER,
Rochester, N.Y., March 6, 1975.

HON. CASPAR W. WEINBERGER,
Secretary of Health, Education and Welfare,
Washington, D.C.

Dear Mr. Secretary: The reports of the Advisory Council on Social Security, appointed by you in April 1974, are enclosed herewith for transmission to the Congress and to the Trustees of the Trust Funds for Federal Old-Age and Survivors Insurance, Disability Insurance, Hospital Insurance, and Supplementary Medical Insurance, as required by section 706 of the Social Security Act.

Sincerely yours,

W. ALLEN WALLIS,
Chairman, Advisory Council on Social Security.

(IX)

FOREWORD

Section 706 of the Social Security Act requires appointment every 4 years of an Advisory Council on Social Security consisting of a chairman and 12 other members representing the general public, the self-employed, and organizations of employers and employees. The appointment of this Advisory Council on Social Security was announced by the Secretary of Health, Education, and Welfare in April 1974.

The Advisory Council on Social Security, according to the law, is required to review the status of the four social security trust funds in relation to the long-range commitments of the social security program, the scope of coverage, the adequacy of benefits, and all other aspects of the program, including its impact on public assistance programs under the Social Security Act. (See Appendix C for the statutory authority and mandate for the Council.) The Committee on Ways and Means of the House of Representatives also directed this Advisory Council to "consider the role of the social security program in providing an adequate level of benefits in addition to an equitable benefit based on individual earnings" (Report on H.R. 11333, November 9, 1973). In addition, the social security Boards of Trustees suggested that this Council be asked to study the causes and "ways of dealing with the emerging long-range actuarial status of the trust funds" (House Document 93-313, June 3, 1974, p. 37).

While the Council is submitting separate reports on the cash benefits and Medicare programs, as required by the law, the reports reflect the Council's decision to focus primarily on the retirement, survivors, and disability insurance programs. For the reasons discussed in the report on the Medicare program, the Council reviewed only Medicare financing. The reports on the financing of Medicare hospital insurance (part A) and of supplementary medical insurance (part B) are combined as they were in the reports of the 1971 Advisory Council on Social Security.

This Advisory Council on Social Security held the first of nine 2-day meetings May 3 and 4, 1974. Average attendance was 85 percent of the members or, in a few instances, their representatives. A subcommittee of four Council members examined the financing of the social security program and the assumptions and methodology used by the Office of the Actuary of the Social Security Administration. This subcommittee was charged with undertaking the study suggested by the Boards of Trustees in their 1974 report. Aiding the subcommittee in its work were five of the Council's consultants from outside the Federal Government, three of them actuaries and two economists. The subcommittee's report and the report of the actuarial and economic consultants are in Appendix A.

Another subcommittee was appointed to study the treatment of men and women under social security with respect to sex and marital status. This subcommittee's report is in Appendix B.

XII

The Council also asked a Task Force of four Council members to deal with the charge from the House Committee on Ways and Means to examine the adequacy and equity of social security. In addition, this Task Force was asked to examine the basic philosophy of social security—its purpose, principles, and role in relation to means-tested programs and private sources of income protection. The Task Force's findings were endorsed by the Council and are included in the section of the Council's report dealing with these subjects.

This was the first Advisory Council on Social Security to operate under the provisions of the Federal Advisory Committee Act. All of the meetings of the Council were open to the public, advance notice of each meeting having been published in the Federal Register. In addition, the Council invited through a notice in the Federal Register and a press release public comments and suggestions about the social security program. As a result, the Council received several hundred letters from members of the public, organizations, and State and local officials.

The Council wishes to express its appreciation for the consultation and advice received from representatives of the Department of the Treasury, the Department of Labor, and the Office of the Assistant Secretary for Planning and Evaluation, Department of Health, Education, and Welfare. Commissioner of Social Security James B. Cardwell, Deputy Commissioner Arthur E. Hess, and staff of the Social Security Administration also provided invaluable assistance. Among the staff, we would like to give particular recognition to John Trout, who served ably as Executive Secretary of the Council; James E. Marquis, Assistant Commissioner for Program Evaluation and Planning; John J. Carroll, Assistant Commissioner for Research and Statistics; Francisco Bayo and Lawrence Alpern, both Deputy Chief Actuaries; and Mary Ross, Director, Division of Retirement and Survivors Benefits, Office of Program Evaluation and Planning.

MEMBERSHIP OF THE COUNCIL

W. Allen Wallis, *Chairman*, Rochester, New York. Chancellor of the University of Rochester, and a former special assistant to President Eisenhower.

Stanford D. Arnold, Brighton, Michigan. Secretary-Treasurer, Michigan State Building and Construction Trades Council, AFL-CIO.

John W. Byrnes, Arlington, Virginia. Attorney; former U.S. Representative from Wisconsin and former ranking minority member of the House Ways and Means Committee.

Rita Ricardo Campbell, Los Altos Hills, California, Senior Fellow, Hoover Institution, Stanford University; former member of President's Committee on Health Services Industry.

Edward J. Cleary, Flushing, New York. Secretary-Treasurer, New York State Building and Construction Trades Council, AFL-CIO.

Rudolph T. Danstedt, Bethesda, Maryland. Assistant to the President of the National Council of Senior Citizens.

Edwin J. Faulkner, Lincoln, Nebraska. President, Woodmen Accident and Life Company.

Vernon E. Jordan, Jr., White Plains, New York. Executive Director, National Urban League. (Mr. Jordan was unable to participate

XIII

in the Council's work and was represented by Thomas E. Mitchell, Washington, D.C., Deputy Director, Washington Bureau, National Urban League.)

Elizabeth C. Norwood, Washington, D.C. Assistant Research Director, Eastern Conference of Teamsters.

John J. Scanlon, Fairfield, Connecticut. Executive Vice President and Chief Financial Officer (Ret.), American Telephone and Telegraph Company.

J. Henry Smith, Maplewood, New Jersey. Chairman of the Board, Equitable Life Assurance Society of the United States.

J. W. Van Gorkom, Lake Forest, Illinois. President, Trans Union Corporation.

Arnold R. Weber, Vice Chairman, Pittsburgh, Pennsylvania. Dean, Graduate School of Industrial Administration, Carnegie-Mellon University; former Assistant Secretary, Department of Labor; former Associate Director, Office of Management and Budget.

CONSULTANTS TO THE COUNCIL

Phillip Cagan, Professor of Economics, Columbia University.

Hugh Conway, Economist, Office of the Secretary of Labor.

Martin Feldstein, Professor of Economics, Harvard University.

Robert Kaplan, Professor of Industrial Administration, Carnegie-Mellon University

Robert J. Myers, Professor of Actuarial Science, Temple University; former Chief Actuary, Social Security Administration.

Sherwin Rosen, Professor of Economics, University of Rochester.

Charles E. Trowbridge, Senior Vice President and Chief Actuary, The Bankers Life; former Chief Actuary, Social Security Administration.

Howard Young, Consulting Actuary; Special Consultant to the President, United Auto Workers.

SUMMARY OF MAJOR FINDINGS AND RECOMMENDATIONS*

A. CASH BENEFITS

1. PURPOSE AND PRINCIPLES

The earnings-related OASDI program should remain the Nation's primary means of providing economic security in the event of retirement, death, or disability. It should be supplemented by effective private pensions, individual insurance, savings, and other investments; and it should be undergirded by effective means-tested programs. Future changes in OASDI should conform to the fundamental principles of the program: universal compulsory coverage, earnings-related benefits paid without a test of need, and contributions toward the cost of the program from covered workers and employers.

2. BENEFIT STRUCTURE—REPLACEMENT RATES

The provisions of present law for computing average monthly earnings, on which benefits are based, and for adjusting the benefit table in the law to changes in prices may result over the long range in unintended, unpredictable, and undesirable variations in the level of benefits. The benefit structure should be revised to maintain the levels of benefits in relation to preretirement earnings levels that now prevail. Benefits for workers coming on the rolls in the future should be computed on the basis of a revised benefit formula using past earnings indexed to take account of changes during their working lives in the average earnings of all covered workers. As under present law, benefits for people on the rolls should continue to be increased as price levels increase.

3. RETIREMENT TEST

The provisions of the present retirement test should be modified so that beneficiaries who work can retain more of their benefits. Instead of reducing benefits by one dollar for every two dollars of earnings above the exempt amount of earnings, as under present law, one dollar of benefits should be withheld for every three dollars of earnings between the exempt amount and twice the exempt amount, and one dollar for two dollars above that level. Also, the provision under which a full benefit may be paid for any month in which a beneficiary earns less than one-twelfth of the annual exempt amount should be eliminated, except for the first year of entitlement to benefits. The test should be based on annual earnings.

*The Council's findings and recommendations reflect a consensus of the Council and not necessarily the precise view of any individual member on any issue. To the extent that Council members have chosen to express their differences from the Council's findings and recommendations, such expressions are contained in the section of statements at the end of the report. Footnotes at appropriate points in the body of the report call attention to these supplementary statements.

XVI

4. TREATMENT OF MEN AND WOMEN

The requirements for entitlement to dependents' and survivors' benefits that apply to women should apply equally to men; that is, benefits should be provided for fathers and divorced men as they are for mothers and divorced women and benefits for husbands and widowers should be provided without a support test as are benefits for wives and widows. At the same time, the law should be changed, effective prospectively, so that pensions based on a person's work in employment not covered by social security will be subtracted from his social security dependents' benefits. Other provisions of the social security program which are the same for men and women but which are criticized because they appear to have different average effects on men and women (or different average effects on the married and the unmarried) should not be changed.

5. OTHER RECOMMENDATIONS

(a) *Universal compulsory coverage*.—Although social security covers over 90 percent of workers, the gaps that remain often result in unwarranted duplication of benefits. Social security coverage should be applicable to all gainful employment. Ways should be developed to extend coverage immediately to those kinds of employment, especially public employment, for which coordinated coverage under social security and existing staff-retirement systems would assure that total benefits are reasonably related to a worker's lifetime earnings and contributions.

(b) *Minimum benefit*.—Partly because of the gaps in social security coverage, the minimum benefit is frequently a "windfall" to those, such as Federal retirees, who are already receiving a pension based on earnings in employment not covered by social security. Almost all workers who have worked in social security employment with some regularity become entitled to higher than minimum social security benefits. The minimum benefit in present law should be frozen at its level at the time the new benefit structure recommended under number 2 above goes into effect and the new system should not pay benefits exceeding 100 percent of the indexed earnings on which the benefit is based.

(c) *Definition of disability*.—The definition of disability should be revised to provide disability benefits for workers aged 55 or over who cannot qualify for benefits under present law but who are so disabled that they can no longer perform jobs for which they have considerable regular experience. These benefits should be 80 percent of the benefits for those disabled workers who qualify under the present law.

(d) *Miscellaneous*.—Further study is needed on three matters; the effects of the social security program on different racial and ethnic groups, ways of simplifying the social security program and its administration, and the frequency of cost-of-living adjustments in benefits. In addition, a general study of social security should be made by a full-time non-Government body, covering such matters as funding vs. pay-as-you-go, possible effects of social security on capital formation, productivity, the proper size of the trust funds, the incidence of payroll taxes, and other basic questions.

XVII

B. FINANCING

1. ACTUARIAL STATUS

The cash benefits program needs a comparatively small amount of additional financing immediately in order to maintain the trust funds levels. Beginning about 30 years from now, in 2005, the program faces serious deficits. Steps should be taken soon to assure the financial integrity and long-range financial soundness of the program.

2. TAX RATES

(a) *Employee-employer*.—No increase should be made, beyond those already scheduled in present law, in the total tax rates for employees and employers for cash benefits and hospital insurance. However, the OASDI tax rate should be gradually increased, as OASDI costs increase, and the increases should be met by reallocating taxes now scheduled in the law for part A (hospital insurance) of the Medicare program. Income lost to the hospital insurance program by this reallocation should be made up from the general funds of the Treasury. Hospital insurance benefits are not related to earnings, so should be phased out of support from the payroll tax.

(b) *Self-employed*.—The present 7-percent limitation on the tax rate for the self-employed should be removed. The self-employment OASDI tax rate should be the same multiple of the employee contribution rate as was fixed at the time the self-employed were first covered—150 percent.

3. RETIREMENT AGE

The Council recognizes that under current demographic projections there will be a sharp rise in the number of people who will have reached retirement age relative to the working age population in the first several decades of the next century. Although the Council is not recommending an increase in the age of eligibility for social security retirement benefits, the Council does believe that such a change might merit consideration in the next century, when the financial burden of social security taxes on people still working may become excessive.

I. REPORT ON CASH BENEFITS PROGRAM

(1)

CHAPTER 1.—INTRODUCTION

This sixth Advisory Council on Social Security has met under conditions that are without precedent in the history of the social security system.

The Council itself departs from precedent in being the first Council not to include among its members any of the men and women who created the system four decades ago, and in having no member who has served on an earlier Advisory Council. This Council is unique, also, in having had only 8 months for its work instead of the normal 20 months or more.

This 1974 Council differs from previous Councils in having carried on its work entirely in public, as required by legislation enacted in 1972. One consequence of this was that before this Report had even been drafted, its principal recommendations were widely published, often with substantial inaccuracies.

During 1974, social security was the subject of a great deal of attention in the news. Articles and commentary appeared in newspapers and magazines and on television that were often bombastic and inaccurate, including complaints of "unfairness." Charges of "inefficiency" were heard virtually for the first time in the history of the Social Security Administration.*

Widespread attention was given to the annual report of the Trustees of the trust funds, published in June 1974. Emphasis was placed on the Trustees' estimate of a serious long-range deficit in OASDI (Old-Age, Survivors, and Disability Insurance), without comparable emphasis on the fact that the estimate depends on predictions of such unpredictable factors as fertility rates, immigration, inflation, and productivity.

Social security now affects our society and economy to an unprecedented degree. It covers more than 9 out of 10 jobs. Its payroll taxes were \$72 billion in 1974, about 40 percent of all Federal taxes on individuals.**

At the end of 1974, about \$6 billion a month of benefits (including Medicare) was being paid to over 30 million people—about 1 out of every 7 of the population.

Also without precedent are current demographic trends. After a period of high fertility rates, we are now in a period of decline, and fertility rates are lower than ever before in America—in fact, at levels which, if sustained, would lead eventually to a declining population. Since social security is essentially a pay-as-you-go system, benefits to the retired, survivors, and disabled being paid from taxes collected concurrently from those still working, the ratio of workers to

*Nearly all charges of inefficiency were directed against the supplemental security income program. This is not part of the basic social security program, although it is administered by the same agency. The agency had to take over records and administration from State welfare systems. Also, Congress made last-minute changes in the SSI program, just a few days before the agency issued the first checks on January 1, 1974.

**The figure for payroll taxes includes employers' contributions as taxes on individuals, since many economists believe that the employers' share falls mostly on employees. If employers' contributions are not included, the proportion is 25 percent.

beneficiaries is of critical importance in determining the cost to workers. At present there are about three workers to support each beneficiary, but it is estimated that if current trends continue there will be eventually only two workers to support each beneficiary. (The resulting burden on those still working may be offset to some degree by a reduction in the number of children to be supported and educated.)

Another development now beginning to affect social security to an unprecedented degree is the changing structure of the family. Social security contributions are levied on an individual basis, but the benefits are awarded on a family basis. The program was built on an implicit assumption that most people marry and stay married to the same spouses throughout their lives, and that the man is the "head of the household" and principal source of the income on which others in the family are dependent. For half a century divorce and remarriage have become increasingly common, with not only two but three or more spouses in a lifetime becoming less unusual. In the past decade, formation and separation of families without legal sanction has appeared, as have living groups that are dissimilar to the traditional family. Even the traditional family is changing greatly in the degree of its dependence on an economically dominant male. In 1973, about 42 percent of married women participated in the labor force at any one time and over 50 percent at some time during the year, and it is estimated that 90 percent of all women participate at some time during their lives. Earnings due to "second" earners have become a substantial part of family finances.

Another recent development is that economists interested in such specialties as public finance, economic growth, welfare theory, econometrics, and accountancy have begun analyzing various aspects of social security. Some of these economists express concern that social security may have a depressing effect on productivity by reducing the flow of savings, on which depends the supply of more and better tools and machines for workers.¹

The social security program has become complex. It is difficult for people to understand their rights and to determine the benefits they should receive unless they obtain assistance from social security employees or outside experts. Such complexity makes the system vulnerable to misinterpretation and uninformed criticism.

Increases in the complexity of the social security program have been accompanied by the assignment of administrative responsibility to the Social Security Administration for programs that are not social insurance. Supplemental Security Income, the largest and most recent of these new programs, has already been mentioned. Another example is the program of special benefits for victims of "black lung" disease. While this development has resulted at least in part from the desire to take advantage of the Social Security Administration's organization, ability, and experience, it has complicated the task of administering the social security program and made the program more difficult to understand.

¹ By Mr. Arnold, Mr. Cleary, and Mrs. Norwood. The observation that social security may have a " . . . depressing effect on productivity by reducing the flow of savings . . ." is highly speculative and contradictory. Economists have observed that employers shift the cost of the social security tax to individual workers in lieu of higher wages, or pass the cost along to consumers via higher prices. To the extent this is done employer savings are not affected by the social security tax.

Another condition without precedent is that the relationship between benefits and pre-retirement earnings now depends on fluctuations in wages and prices rather than on explicit decisions by Congress. A laudable move to apply automatic cost-of-living adjustments to benefits has inadvertently introduced instability, unpredictability, and uncontrollability into the relationship between purchasing power after retirement and purchasing power before retirement. (This can be corrected; see Chapter 3 of this Report.)

With the convergence of so many unprecedented developments, it is not too dramatic to say that the social security program is at a juncture of decisive importance. Major aspects of social security that deserve attention, but that the Council did not have time to analyze thoroughly, include: full reserve funding vs. current cost financing; the effects of social security on productivity, capital formation, and private savings; the relationship between private pensions and social security; and the appropriate size of the trust funds. To lay the groundwork for the next Advisory Council on Social Security, a comprehensive study of these and related issues should be conducted by a full-time non-Government body, such as a research organization experienced and qualified in the public policy field. These studies should be under the general guidance of a board composed on much the same criteria as the law specifies for Advisory Councils on Social Security.²

This Council decided early in its deliberations to focus on relatively few topics.

We gave priority to the financial soundness of social security, not only because the basic law under which we were appointed required it but also because of urgent concerns recently expressed by members and staff of Congress, especially the Ways and Means Committee of the House and the Finance Committee of the Senate. At our first meeting the Chairman, with the consent of the Council, appointed a Subcommittee on Financing (Rudolph T. Danstedt, Elizabeth C. Norwood, and J. Henry Smith, with Jerome W. Van Gorkom as chairman). The subcommittee's work was the basis from which the Council prepared Chapters 3 and 7 of this Report. The subcommittee's report is Appendix A, and the report of its actuarial and economic consultants is a supplement to Appendix A.

We gave priority also to differences in the treatment of men and women, and of married and unmarried persons. This was partly because of charges that the social security program discriminates against women. It was also because the "Equal Rights" amendment to the Constitution may be nearing passage and may require changes in social security; and even if the amendment is not adopted, it appears likely that the same effects will be achieved, though less abruptly, by court decisions. At our first meeting, the Chairman, with the consent of the Council, appointed a Subcommittee on Treatment of Men and Women (Edward J. Cleary and John J. Scanlon, with Rita R.

² By Mr. Danstedt. I question the need and desirability of utilizing a full-time non-government body on a volunteer or contract basis to conduct the study and analysis Congress has charged a Social Security Advisory Council to perform. Given time—which was not allowed to the 1974-1975 Advisory Council—a Council, as a sort of citizens' review board, can and should define issues that need study, request or commission such studies from the experts of the SSA and other Government agencies and outside groups, and then assess and evaluate the opinions advocated. Non-governmental sponsorship of research is no guarantee of objectivity.

Campbell as chairman). Its work was the basis from which the Council prepared Chapter 5 of this Report, and its report is Appendix B.

Similarly, we decided at our first meeting to limit our consideration of health insurance to a cursory review of its financing. The health field alone, had we reviewed all its aspects, would have been as much as, if not more than, we could have handled in our 8 months. Furthermore, it is receiving extensive and intensive study in connection with proposals for national health insurance, and it seemed unlikely that we could add anything.

At our second meeting, the Chairman, with the consent of the Council, appointed a Task Force on the Purpose and Principles of Social Security (Edwin J. Faulkner, Stanford D. Arnold, and Thomas E. Mitchell, with John W. Byrnes as chairman). Its work was the basis from which the Council prepared Chapter 2 of this Report.

By our third meeting it had become apparent to us that the operation of the new automatic cost-of-living adjustments to benefits, enacted in 1972, required correction—in particular, to make the relationship of benefits to wages more predictable, more amenable to congressional control, and less subject to unpredictable variations in prices and wages—and we assigned this as a problem of high priority, through the Subcommittee on Financing, to our actuarial and economic consultants. Their work is reflected in Chapter 3 of this Report, in Appendix A, and in their report, which supplements Appendix A and contains an Addendum on “decoupling.”

A great deal of comment from the public and in articles or talks about social security centers on the “retirement test”—the withholding of some or all benefits from people under age 72 who earn more than a certain amount (\$2,520 in 1975) but not from those who have other income, however great, or are older than 72. We decided, therefore, that we should study this issue, and our conclusions are in Chapter 4.

This then explains the major emphasis of our report. A number of other topics that we considered are discussed in Chapter 6.

CHAPTER 2. PURPOSE AND PRINCIPLES OF SOCIAL SECURITY

This Council decided early in its deliberations to review the original purpose of the social security cash benefits program—now called old-age, survivors, and disability insurance—and to reexamine the role of the program in light of today's needs and the principles on which the program is based. The Council also considered, at the request of the House Committee on Ways and Means, the social adequacy and individual equity of the social security program.¹ The conclusions and recommendations of the Council on these matters are based on the work of a Task Force of four Council members which was formed to study this subject.²

SECTION 1. HISTORICAL DEVELOPMENT

The original purpose of the social security cash benefits program is reflected in the 1935 report of the President's Committee on Economic Security, the congressional committee reports and debates on the Social Security Act of 1935, and other public records. In developing the 1935 Act, the framers sought to establish a long-range program to prevent a recurrence of the widespread economic plight of the aged prevalent during the depression of the 1930's. The basic approach agreed upon was a contributory Federal social insurance program that would provide, without a means test, benefits to help replace earnings lost because of retirement in old age. The purpose of this program was to prevent widespread dependency rather than to alleviate dependency after it occurred and to do so in a way complementary to traditional reliance on self-help and individual and collective initiative.

Both the worker's contributions and the benefits he would be entitled to in retirement were related to earnings. Since the benefits were intended to help replace earnings lost on account of retirement in old age, beneficiaries would have to meet a test of retirement. But there was to be no means test. Because the benefits would not be subject to a test of need, workers would have an incentive to build up other resources—private pensions and insurance, savings accounts, home ownership, and other forms of property which reflect thrift and investment—so that they could maintain a higher standard of living in retirement than social security benefits alone would support.

The Social Security Act of 1935 also established a system of Federal matching grants for State old-age assistance programs that would provide payments based on need. The purpose was to alleviate then-existing poverty among the aged and the deprivation that might arise

¹ In November 1973, the Committee on Ways and Means of the House of Representatives, recognizing the dual role of social security as a system whose purpose is both social adequacy and individual equity, requested this Council "... to consider the role of the social security program in providing an adequate level of benefits in addition to an equitable benefit based on individual earnings levels." (House Report #93-627, 9 November 1973).

² The members of the Task Force were Stanford D. Arnold, Edwin J. Faulkner, and Thomas E. Mitchell, with John W. Byrnes as Chairman.

in the future among the aged whose basic needs remained unmet either by the social insurance program, private efforts, or other means.

Thus, the foundations of today's three-part income maintenance system for older people in retirement—*social insurance* supplemented by *private means* and, when necessary, *means-tested programs*—were established by this country's first national social security law and were built upon later with the addition of protection for disabled employees and self-employed people, and for the dependents of retired, disabled, and deceased workers. As between social insurance and means-tested programs, the former was intended to have the primary role.

The heavy reliance placed upon the social insurance approach reflects the importance attached to preventing widespread dependency rather than alleviating it after it has occurred; to having employees, their employers, and the self-employed contribute toward the cost of the program; to conditioning the right to benefits on work and relating the level of a worker's benefits to his past earnings; and to encouraging individual initiative and thrift by establishing benefits without a test of need.

The cash benefits program has been financed since its inception by an earmarked tax levied equally on employer payrolls and employee earnings.³ When the social security system was being planned, and at times since then, the possibility of general revenue support for this system was considered. However, over the years Congress has held that with minor exceptions (e.g., the special age-72 benefits) social security cash benefits should be financed out of payroll taxes. Such financing helps distinguish OASDI from purely welfare programs and permits greater understanding of social security costs.

Although the social security program has undergone many changes since 1935, these original principles have been preserved and are deeply rooted in today's system. Together with compulsory coverage—an essential characteristic of social insurance⁴—they constitute the basic principles of both the original contributory social security program and today's old-age, survivors, and disability insurance program (OASDI).

SECTION 2. ADHERENCE TO FUNDAMENTAL PRINCIPLES

The earnings-related OASDI program has been accepted by the American people as the Nation's primary means of providing economic security in the event of retirement, death, or disability. A contributory national social insurance system that aims to prevent widespread dependency by providing benefits that help replace earnings lost on account of retirement in old age, disability, or death should be preserved. OASDI lends itself well to supplementation

³ When the self-employed were later included in the social security program, a separate tax on self-employment earnings was imposed.

⁴ From time to time, questions are raised about the need for compelling participation in social security. The Congress made the program compulsory from the beginning, in 1935, and has continually reaffirmed the need for compulsory coverage as the program has been extended to additional groups of workers over the years. Since the effectiveness of social security in achieving the objective of providing general economic security and preventing widespread dependency, the overall equity of the system, and the soundness of its financing, all depend on compulsory and preferably universal participation, it is clear that a choice today between compulsory and voluntary coverage is really a choice between having or not having a social security program. Without compulsory participation, the present social security program could not exist.

by private pensions, savings, and other individual and group efforts to provide economic security. While social insurance is a better public program for income maintenance than public assistance, effective means-tested programs to provide basic income for people with low incomes are a necessary third tier to meet any essential need for cash income that OASDI and private resources cannot fulfill in individual situations.

The Council recommends strongly that future changes in OASDI conform to the fundamental principles on which the social security cash benefits program has always been based. These principles are sound and can be relied upon to help assure the continuing effectiveness of OASDI. Compulsory participation by employees, employers, and the self-employed, with coverage as nearly universal as possible, is the only practical way for the program to prevent widespread dependency, because the risks of income loss due to retirement in old age, death, and disability are common to virtually all who depend on earnings from work. Benefits that are related to past earnings and that are independent of any test of need reinforce individual initiative and self-reliance. The fact that covered workers contribute toward the cost of the program supports the principle of benefits paid without a needs test and encourages a responsible attitude toward the program.

For most Americans, earnings from work are the main source of income for themselves and their families. When those earnings stop or are sharply reduced because of retirement in old age, severe and extended disability, or death, OASDI benefits are payable in most cases to replace part of the lost earnings. Over 92 percent of those now reaching age 65 are eligible for benefits. This percentage will increase in the future under present law. Also, 95 out of every 100 children under age 18 and their mothers have survivorship protection, and about 80 percent of those aged 21 to 64 have protection in the event of long-term disability. These percentages will increase further if coverage under social security becomes more nearly universal, as the Council recommends (Chapter 6, section 1).

SECTION 3. PRESERVATION OF A TRIPARTITE SYSTEM OF INCOME PROTECTION ^{5 6}

While its coverage should be as nearly universal as possible, OASDI should not be expected to perform the entire job of assuring economic security for the aged and the disabled and their families or for survivors. A clear understanding of the respective roles and relationships among social security, private efforts, and means-tested programs is essential to continued orderly development of effective income support

⁵ See the statement of Mr. Arnold, Mr. Cleary, and Mrs. Norwood.

⁶ By Mr. Danstedt. We do not have any system—tri-partite or three tier of income protection. SSI does provide income to the elderly poor at a level below the poverty level, but requires a means test. An individual is not entitled to SSI as a matter of right—only if he meets demeaning eligibility conditions.

The so-called third tier—for all practical purposes—private pensions—is as yet an unfinished structure with estimates indicating that perhaps not more than one-third of Social Security recipients have this form of protection—mostly the elderly. Private survivorship and disability insurance programs are even more limited.

Social Security is thus the only solidly assured form of income protection provided as a matter of right to the disabled, survivors and the elderly.

The caption for this section, if it is to describe what is the actual state of affairs, should have read: SSI—Means tested income provision/Social Security—Wage related income protection provided as a matter of right/Private Pensions—Income protection plans supplementary to Social Security, while growing, are presently available to only a minority of Social Security recipients. A short title might be: The Roles of SSI, Social Security and Private Pensions in Income Provision.

for individuals and families. As the primary means of partially replacing earnings, OASDI is the core of the Nation's total system of income protection. OASDI should be supplemented by effective private pensions (as well as individual insurance, savings, and other investments), and undergirded by effective means-tested programs. Private efforts (group and individual) are essential to fulfill needs and desires for protection above and beyond a floor of protection provided through the social security program, and such efforts are desirable from the standpoint of the individual as well as the Nation. For those whose work has been so sporadic, or whose earnings have been so low, that their social security benefits and other resources are inadequate, means-tested programs are essential to provide help in meeting day-to-day needs.

The recently instituted supplemental security income program (SSI) and the recently enacted Federal private pension legislation are two major steps intended to strengthen the overall income maintenance system in the United States. SSI, as a means-tested program, can be expected to provide an effective way of meeting the income needs of those whose OASDI benefits are low or non-existent because of marginal attachment to employment covered by social security. Improvements in private group pensions and in plans for individual retirement programs for the self-employed and for employees not covered under a group plan enhance the role of the private sector in contributing to economic security. The Council recognizes the need for continuing review of the adequacy and effectiveness of the present three-tiered approach to assuring economic security, including, for example, the issues of portability and vesting of private pensions.

SECTION 4. SOCIAL ADEQUACY AND INDIVIDUAL EQUITY ⁷

In addressing the adequacy and equity aspects of social security, it is significant to note that social insurance and private insurance share some characteristics but have distinct differences. Among the differences are the features of social insurance designed to achieve such broad social objectives as universal compulsory coverage, a benefit ratio weighted in favor of those who have had lower earnings, and a different standard for determining actuarial soundness.⁸

Congress, through its establishment of benefit levels, determines the extent of the system's "social adequacy." Opinions may differ as to whether a given level of benefits provides "the floor of protection" which has been the social goal of the system. What constitutes adequacy for one might seem affluence to another and penury for a third.

This Council has had neither the time nor the facilities to conduct the extensive research that could lead to definitive conclusions based on sound evidence as to the extent to which OASDI benefits do in fact supply "a floor of protection." Before such a study could proceed, there would need to be agreement on standards of adequacy, and this would be difficult to achieve because of wide differences in lifestyles, varying geographic conditions, and a host of other factors.

⁷ See statement by Mrs. Campbell.

⁸ Social insurance systems supported by the taxing power of government can and should operate on the basis of "current funding" whereas private insurance requires the accumulation of reserve funds sufficient to pay all existing obligations.

Nonetheless, in evaluating adequacy in the social security program, it is necessary to take into consideration not only the current and anticipated role of the program in replacing lost earnings, but also the effect of the program on incentives for private initiative and thrift, the capacity of the economy as a whole, and the willingness of taxpayers to finance a given level of protection.

The social adequacy of the program must also be measured in relation to the degree of individual equity the program provides. Only if the program, as a whole, can be considered to be reasonably equitable, will it be viable.

The concepts of social adequacy and individual equity are not easily harmonized. The social security law places a high priority on social adequacy so as to achieve the public purpose of providing a floor of protection for those whose earned income has been substantially lost because of death, disability, or retirement in old age. In this context, social adequacy means that the benefits provided will supply the eligible recipients with a certain standard of living when such benefits are supplemented by private means or undergirded by public assistance. Several elements of social security are intended to assure the social adequacy of the program:

First, full-rate benefits were provided for workers who were already near retirement age when the program was established or when their work was first covered. If the cash benefits paid in the early years of the program had been no larger than the amounts that could be financed by the contributions paid by individual beneficiaries and by their employers, the benefit amounts would have been too small to make a meaningful contribution to reducing dependency.

Second, under social security, the low-paid worker gets a benefit that is a higher proportion of past earnings than does the higher paid worker. This is accomplished through the use of a benefit formula that is weighted in favor of low-paid workers. These provisions recognize that lower paid workers and their families have less margin for reduction in income than do workers with average or above-average earnings. The law also provides a "special" minimum benefit for workers (and their families) who have worked under the program regularly over the years but at relatively low wage levels in order that regular long-term workers who were self-supporting during their working years may not find it necessary to turn to public assistance when they can no longer work because of ill health, disability, or old age.

Third, since 1939, the social security law has provided benefits for dependents and survivors of insured workers. These provisions were enacted in recognition that, if social security is to be effective in reducing dependency, it is necessary to provide benefits not only for workers but for dependents and survivors of insured workers as well. Thus, workers who have dependents get more protection in relation to their taxes than do single workers who have no dependents.

Individual equity connotes that the contributor to the system (the taxpayer) receives benefit protection directly related to the amount of his contributions. Under a social insurance system, only a measure of equity can be achieved because of the need to accomplish social adequacy for workers with low earnings in whose favor the benefit formula must be heavily weighted and workers with families. None-

theless, it is important to retain the ingredient of individual equity in order to assure the support of the system by the great majority of taxpayers whose earnings are above the lowest levels. It has always been considered important to give assurance that even those taxed the most would "get their money's worth" from the system. This has been done, not precisely, but in a very broad way if one accepts the view that the employer's tax is not assignable to the individual employee but is pooled for the benefit of all employees. (Many economists, however, hold that the employer's tax is shifted to the individual worker in lieu of higher wages. Also, even if the incidence of the employer's tax were not directly on the worker, the worker would pay some part of the costs of the social adequacy element of social security through the price of goods and services he consumes or in his taxes.)

The Council emphasizes that in considering equity under the social security program it is necessary to take into account that social security is more than a program of retirement insurance. The program also provides disability and survivors insurance; this is often ignored or discounted in evaluating social security. Even if a worker does not become disabled prior to reaching retirement age, and even if he no longer has a dependent spouse or young children when he dies, he nevertheless has had dependents and survivors insurance protection for many years. Like any other insurance protection, this protection has both a cost and a value. In fact, less than two-thirds of the social security contribution for cash benefits covers retirement insurance.

Another fact that is sometimes overlooked in assessing social security is that the protection a worker gets under the program grows as wage levels rise during his working career and the purchasing power of his benefits is, by law, kept up to date with the cost of living while he is on the rolls.

The continued acceptability of the present OASDI system depends importantly on maintaining OASDI benefits as an earnings related program, not a means-tested program. The system has been presented to the American people as such. It is too little understood that today's workers and their employers pay taxes to support the currently aged, disabled, and survivors and that there is an implied social contract that future generations of workers and their employers will finance the cost of the future benefits that today's workers expect to receive.

The social adequacy and individual equity of OASDI can only be evaluated in the context of America's three-tiered structure for income maintenance. Without the undergirding of means-tested programs for those with the lowest earnings or the supplementation through private means for those who have had higher earnings, OASDI might be judged deficient for many recipients. As has been noted above, the expansion and proliferation of means-tested programs by government has diminished or eliminated the need for further emphasizing the social adequacy of OASDI benefits while rising incomes and devices for encouraging personal thrift will enhance supplementation of social security benefits through private means. What may be conceived as equitable and adequate in social security benefits may vary with time and with demographic and economic conditions, but it is essential that a balance be maintained among social security, means-tested programs, and private plans for income maintenance and capital accumulation.

CHAPTER 3. INFLATION AND SOCIAL SECURITY

SECTION 1. SUMMARY

The Council recommends that until retirement all earnings should be "indexed." That is, the actual money earnings of a worker before retirement should be adjusted in accordance with an index of changes in the average earnings of all workers. Average monthly indexed earnings (AMIE) would be used as the basis for determining benefits instead of actual average monthly earnings (AME) as now. After retirement, benefits should be adjusted according to an index of changes in the cost of living, as they now are under the 1972 amendments. Replacement rates (the proportion of earnings replaced by benefits) that are currently produced by present law should be continued.¹

Until 1972, social security payments were computed on the basis of a fixed relationship between benefits and an individual's average monthly earnings² in covered employment. With the steady inflation in the post-war period, the benefits of retired individuals soon failed to keep pace with increases in prices. Congress, in recognition of this erosion of benefits, raised benefits from time to time on an ad hoc basis to maintain the real purchasing power of social security benefits. As Table A shows, Congress generally has raised benefits more than in proportion to increases in consumer prices.

Congress in 1972 enacted automatic cost-of-living increases in social security benefits. Automatic cost-of-living increases in benefits are an important improvement in social security. The method by which they are made, however, needs basic changes, particularly because it has an apparently unintended erratic effect on the future relationship between benefits and the earnings they replace.

Each year, the table that sets out the benefits payable at various levels of average monthly earnings is adjusted in accordance with changes in the cost of living during the previous year. The adjustments are "automatic" in the sense that Congress has authorized making the adjustments without further congressional action. Before cost-of-living adjustments were made automatic, there were sometimes delays before Congress increased benefits in response to increases in consumer prices, and these delays imposed hardships on beneficiaries.

The automatic cost-of-living adjustments are made only in the level of payments to beneficiaries (present and future). There is, however, an important effect of inflation while the worker is still earning. Since wages as well as prices increase during inflation, wages earned just before retirement tend to reflect the level of prices and productivity at the time of retirement, and to that extent move the worker to a higher level of benefits. Wages earned many years before retirement,

¹ See statement by Mr. Arnold, Mr. Cleary, and Mrs. Norwood and statement by Mr. Danstedt.

² Throughout this report "earnings" refers to earnings only up to the maximum amount subject to the social security tax.

however, do not reflect the effects of inflation between the time they were earned and the time of retirement, so at retirement when an average is taken of monthly earnings (AME) it is lower than it would be if each month's work had been done at the wage levels prevailing at the date of retirement.

The effects of inflation while a worker is still earning should be allowed for explicitly, and by a different method from that used to allow for the effects of inflation after a worker begins to draw benefits.

The Council therefore recommends that a worker's earnings should be "indexed"—that is, adjusted to reflect increases in average earnings over his working lifetime—up to retirement, and after retirement his benefits should be adjusted according to changes in the cost of living. The benefits paid at a particular AMIE should not be the same, of course, as if it were an unindexed AME. The table of benefits for various levels of AMIE should be set so that post-retirement social security benefits will bear about the same relation ("replacement ratio") as now to earnings just before retirement.

We discuss first the indexing of earnings, then the adjustment of the benefit schedule to use AMIE instead of AME. These subjects are also covered at four later places in this report—in chapter 7, in the report of the Subcommittee on Financing, in the report of the panel of actuaries and economists that supplements the Subcommittee's report, and in the addendum on "decoupling" that is added to the panel's report.

SECTION 2. INDEXING EARNINGS

2.1 EARNINGS AND INFLATION

When consumer prices are rising, wages also tend to rise; so a person who earns during such a period reaches retirement with a higher AME than if there had not been inflation. To the extent that such wage increases are reflected in the worker's AME, the effect of inflation before retirement is allowed for in the AME as calculated at present.

This kind of allowance for inflation before retirement, however, is erratic and inadequate. It is erratic in that it treats differently people who ought to be treated equally; this is explained in section 2.2 below. It is erratic also in that replacement ratios fluctuate unpredictably over time, whereas the fundamental purpose of social insurance indicates that replacement ratios should be predictable and should be set deliberately by Congress, not left to interrelations and cross-currents among such forces as changes in consumer prices, money wages, and productivity; this is explained in section 2.3 below. It is inadequate because only the final wages reflect the price level when the worker retires, and most of the monthly earnings included in his AME relate to periods when the price level was lower, thus resulting in an AME that, in a period of inflation, is too low; this was explained in section 1 above.

2.2 STABILITY OF REPLACEMENT RATIOS

Congress has in the past worked out a schedule relating benefits to earnings, making conscientious efforts to balance social adequacy against individual equity. Thus, benefits increase with increasing average monthly earnings, thereby recognizing the criterion of indi-

15

vidual equity; but increases in benefits are less than proportional to increases in AME, thereby recognizing the criterion of social adequacy. In 1974, benefits were about 120 percent of the first \$110 of AME, dropped to 44 percent of the next \$290 and to 41 percent for the next \$150, then rose to 48 percent of the next \$100 of AME, then dropped to 27 percent of the next \$100 and tapered off to a minimum of 20 percent of the last \$100 of AME. (The highest AME possible for a man retiring at age 65 in 1974 was \$511, and the maximum benefit was \$305 per month.) Benefits have been carefully controlled by Congress in the past. But the method used for automatic cost-of-living adjustments in benefits has the side-effect of making replacement ratios (benefits as a proportion of earnings just before retirement) subject to unpredictable variations caused by changes in wage and price levels, an effect that presumably was not intended. The result is that replacement rates, instead of being controlled by conscious and deliberate policy set by the Congress, can fluctuate up or down with the tides of inflation.

This loss of control and stability comes about in large part because of a compounding in the inflation adjustment. For those who have retired, the adjustment takes place only in the benefit schedule, and works well. Those who have not retired, however, will get a partial adjustment for inflation through higher earnings before retirement. These higher earnings will be reflected in their AME's when they retire, thus carrying them to higher points on the benefit schedule than if there had not been inflation. At those higher AME's, the benefits themselves will also have risen to take care of people previously retired. Thus, there will be a compound effect of entering the schedule at a higher AME as a result of earnings increases and then finding that the benefit scheduled for that AME has itself been increased to reflect the effects of price increases.

The extent to which this compounding will change replacement ratios, and even whether it will raise them or lower them, cannot be foreseen. The changes will depend on the behavior of consumer prices, on the behavior of average earnings, and on the relation between them. The changes will not affect people in like circumstances alike (this is explained in section 2.3 on equity). As the report of our Subcommittee on Financing shows, sustained inflation at a high rate—especially if prices rise as fast as wages—would lead to replacement ratios substantially greater than 100 percent. Under the present provisions for financing the system, such replacement ratios would impose an excessive burden on those still working, so they could ultimately jeopardize the whole system, or at least necessitate substantial reductions of benefits from the levels that people had been led to expect.

Indexing earnings before retirement to changes in average earnings and indexing benefits after retirement to changes in prices will make it possible to eliminate the compounding of adjustments to inflation, to restore stability and predictability of replacement ratios and put them firmly under congressional control, and to strengthen the long-run financial integrity of the system.

2.3 SOME CONSIDERATIONS OF EQUITY

People retiring at the same time may not have earned their retirement benefits at the same times. A person starting to draw benefits in

July 1975 with 10 years of covered earnings, for example, might have received those earnings from 1951 through 1960. Another person whose benefits also start in July 1975 might have earned his coverage from 1965 through 1974. Even if both had received the same pay, measured in constant dollars, the one who earned 1965-74 would have a higher AME than the one who earned 1951-60, because of inflation from 1951-60 to 1965-74. Furthermore, people who earned 1965-74 received on the average higher purchasing power than those who performed the same work 1951-60, because of a general increase in productivity over the 14 years. (Total gains in productivity over periods of 14 years have averaged nearly one-third.)

The preceding comparison between two people whose covered earnings were so brief and so far apart is an extreme one, to be sure, but the same forces work, though in lesser magnitude, for any two people whose periods of coverage are different.

To see this, consider two people who have experienced the same pattern of lifetime earnings in terms of purchasing power, but the older of whom starts work 2 years earlier than the younger and retires 2 years earlier. Suppose that the older person had been covered by social security for the 20 years before he retired, that there had been no inflation or deflation during that period, and that his AME on retirement was \$500. Suppose that during the 2 years that the younger person works after the older person's retirement, wages and consumer prices both increase by 10 percent per year. Clearly, in the first year of the younger person's retirement, and thereafter, both people should receive the same social security benefits. In fact, the older person will receive less under the present law.

The older person retiring at age 65 in January 1975 would be entitled by his \$500 AME to benefits of \$299 per month. With inflation of 10 percent per year this would rise (ignoring the lag in the adjustment) to \$329 the next year and then to \$362 in the year the younger person retires. The younger person would retire with an AME of \$508, which would entitle him to a monthly benefit of \$366, about 1 percent more than the older person receives. With all the same assumptions except that the younger person retires 4 years later instead of 2, his advantage is more than 3 percent.

Our recommendation is that actual earnings for each year be multiplied by the ratio of average earnings of all workers in the year of retirement to average earnings of all workers in each past year used in computing the benefit. If a worker retires in 1975, for example, and if all earnings averaged 4 times as high in 1975 as in 1951, 4 times the worker's actual earnings in 1951 would be the indexed earnings used in computing the AMIE. Thus, everyone retiring in 1975 would have all his actual earnings, regardless of when they were earned, restated to an equivalent 1975 figure.³

SECTION 3. RELATING BENEFITS TO INDEXED EARNINGS ⁴

By "benefit schedule" we mean a table which shows for every possible AMIE what the corresponding primary insurance amount

³ This states the recommendation in principle only. For further discussion, see the report of our Subcommittee on Finance and the report of their actuarial and economic consultants. Among important technical matters that must be worked out are what index of wages or earnings to use, how frequently to index, and how to bring about the transition.

⁴ By Mr. Mitchell. Past discrimination is perpetuated by adoption of a 100 percent replacement ratio of the AMIE over the greater portion of a beneficiary's working career. The black-to-white income ratio has risen sharply over the last ten years. If wages are remedied for past discrimination late in the work history, the benefit will tend to perpetuate the past discrimination.

(PIA) is. The PIA is the amount that a worker who retires at age 65 receives as a result of his earnings. Other benefits—for example, to the spouse or surviving spouse of an insured worker—are calculated by applying certain percentages to the PIA. Thus, to discuss the relation of benefits to the AMIE we can regard the PIA as standing for the whole complex of benefits.

The present benefit schedules which relate PIA to AME have several complications that the Council proposes be eliminated in view of the new supplementary security income (SSI) program and of the proposed use of AMIE instead of AME.

The present law provides that the PIA shall not be less than \$93.80 per month, no matter how small the AME. Since there is now a new system, SSI, to provide welfare payments based on need, we recommend that the minimum be fixed permanently at \$93.80, and that for future beneficiaries it not be increased as prices increase. (After a beneficiary starts drawing the \$93.80 it would, however, rise with further rises in prices.) The effect of “freezing” the minimum in this way will be gradually to eliminate it, since with rising wage rates and indexing of earnings virtually everyone who retires will qualify for more than \$93.80 per month. (At present, anyone who has earned \$1.95 an hour or more for an average of 9 hours a week or more qualifies for more than \$93.80.) Our recommendation about the minimum benefit is discussed further in chapter 6, section 2.

Under the present benefit schedule, at AME levels of \$110 or less a worker's benefits after retirement are about 20 percent higher than average earnings on which benefits are based. This anomaly is partly an effort to compensate for failure to index earnings, recognizing that low EAM's may represent earnings received long ago, when wage rates and prices were lower. The Council recommends that benefits not exceed AMIE. Up to a certain AMIE, monthly benefits should be equal to AMIE.

The Council further recommends that above the levels of AMIE for which benefits equal AMIE, benefits should increase in proportion to increases in AMIE. Thus benefits would be related to AMIE by a simple formula:

100 percent of the first A dollars of AMIE
plus
 B percent of AMIE above A dollars

Values of A and B can be determined which will give approximately the same replacement ratios as now occur. The value of A would be changed every year in the same way that the contribution and benefit base is adjusted, that is, in accordance with increases in average covered wages. (See chapter 7 for further discussion and possible alternative formulation.)

This formula is simple. It recognizes the need for a degree of social adequacy by setting benefits which decline steadily as percentages of AMIE as AMIE increases. It recognizes the need for a degree of individual equity by increasing cash benefits in dollars as AMIE increases. It removes from social security, and support by payroll taxes, a benefit that should be related to need, handled through SSI, and financed from general revenues.

The formula, by reducing the role of the minimum and by eliminating benefits in excess of earnings, would alleviate the problem that the

minimum and the 120-percent benefit, which were intended for the needy, often are paid to people who are well off in comparison with the people for whom these special benefits are intended. This is frequently the case with people whose main careers have been in employment which is not covered by social security, but has its own retirement system, for example, U.S. Civil Service employees. They hold a job that is covered by social security long enough to qualify for benefits at the low end of the scale, which are weighted to favor low-income workers, and thus obtain "windfalls" not intended for them. This problem of windfalls will be further alleviated if social security coverage is made universal, as we recommend in chapter 6, section 1.

CHAPTER 4

THE RETIREMENT TEST ¹

*The social security retirement test, under which benefits are not paid in full to a beneficiary under age 72 who has substantial income from work, should be changed. The rate at which benefits are withheld for earnings above the exempt amount should be liberalized. In addition, the retirement test should be changed from a combined annual-monthly test to an annual test only.*²

SECTION 1. PRESENT LAW

Under the social security retirement test, if a beneficiary under age 72 earns more than the annual exempt amount (\$2,400 in 1974, \$2,520 in 1975, and adjusted with rising average earnings thereafter), benefits are withheld at the rate of \$1 in benefits for each \$2 in earnings above that amount. Regardless of his annual earnings, a beneficiary may receive full benefits for any month in which he neither earns more than the monthly measure ($\frac{1}{12}$ of the annual exempt amount—\$200 in 1974, \$210 in 1975) nor performs substantial services in self-employment.

The retirement test is controversial, and is widely regarded as inequitable. The Council has received many letters urging the liberalization or elimination of the retirement test.

SECTION 2. BASIC PURPOSE

The Council has reviewed the provisions of the retirement test and believes that the test is consistent with the basic purpose and principles of social security: to replace, in part, earnings lost because of retirement in old age, disability, or death. Complete elimination of the retirement test is inadvisable.

The retirement test has been criticized because it does not take into account a beneficiary's income from such nonwork sources as dividends, rents, or pension payments. If the test took account of income other than earnings from work, it would no longer be a retirement test but an income test. If it became an income test, the fundamental idea that social security benefits are intended as a partial replacement of earnings from work would be diluted or lost.

¹ See statement of Mr. Byrnes, Mr. Danstedt, Mr. Faulkner.

² By Mr. Mitchell. A relaxation of the retirement test proceeds from one or both of the following assumptions: (a) it is irrational and (b) it imposes a hardship on those receiving low benefits, no other retirement income, and an ability to participate in the labor force to at least a limited degree. My agreement to relax the test flowed from the latter sentiment for the most part. In adopting the proposal outlined in this report, we implicitly recommended a high cost for increased benefits to a group with entirely sufficient retirement income. My alternative to the current proposal would be to exempt from the retirement test those earnings of a beneficiary which, when added to the individual's PIA, did not result in a retirement income greater than the maximum PIA permissible under the law. Because of the lack of universality of Social Security, I would probably include other sources of retirement income such as Federal retirement benefits in calculating the retirement test disregard. Under my alternative, I would retain the present retirement test "tax rate" over the level described. In other words, I would prefer to alter the retirement test in a fashion which focuses on the needy without giving anything to the more affluent retirees.

The most frequently discussed alternative to the retirement test would be to pay social security benefits to all beneficiaries who reach age 65, independent of their employment status at that age. The Council agreed that this annuity concept, in which individuals would receive their "retirement" benefits while still gainfully employed, perhaps at high salaries and wages, is counter to the basic philosophy of social security. In addition, such a recommendation would add a significant cost to the system at a time when future costs are already a matter of concern. Therefore, the Council recommends that a retirement test be retained.

SECTION 3. LIBERALIZE PROVISIONS OF THE RETIREMENT TEST

Despite basic agreement with the concept of the retirement test, the Council recognizes that negative consequences arise from its application. Under the present \$1-for-\$2 withholding rate for earnings above the exempt amount, the additional earnings a beneficiary receives over the exempt amount may result in little additional net income to the worker when allowance is made for the additional effects of Federal income, OASDHI, State, and local taxes, in addition to work-related expenses. Thus, the retirement test discourages work by healthy and able individuals aged 65-71. At the moment there is much concern over unemployment, but recent and current low birth rates will soon cause a decline in the rate of increase in the labor force. The Council is, therefore, concerned with provisions of the law which may act to discourage participation in the labor force.

In addition, the burden of the retirement test probably falls most heavily on low-income individuals who do not have access to private insurance, pension plans, savings, or other sources of nonwork income to supplement their social security retirement benefits. Such individuals are most likely to be dependent on additional income from gainful employment to supplement social security benefits after "retirement."

The Council believes that the most appropriate means for mitigating the disincentive effects of the retirement test and the heavy burden it imposes on low-income workers aged 65-71 is to reduce the withholding rate on earnings which are just above the exempt amount. The Council proposes to establish three levels of earnings that would be subject to different reductions in benefits.

The first level would include earnings up to the annual exempt amount as defined in the present law (\$2,520 in 1975). As under the present law, no benefits would be withheld from earnings within the first level.

The second level would include earnings between the annual exempt amount under the present law and twice this annual exempt amount (\$2,520 to \$5,040 in 1975). Earnings within this level would be subject to a withholding rate of \$1 in benefits for each \$3 earned, instead of the present withholding rate of \$1 for every \$2 earned.

The third level would include all earnings in excess of twice the annual exempt amount under the present law (i.e., \$5,040 in 1975). The withholding rate at this level would be, as under present law, \$1 in benefits for each \$2 of earnings.

The provision of the law which automatically adjusts the exempt amount assures that the second level of earnings, to which the \$1-for-\$3

withholding rate is applied, will increase in the future as general levels of earnings rise.

The main effect of this liberalization would be a significant reduction in the benefits withheld from individuals who earn between one and two times the annual exempt amount. For example, under present law, a worker who earned \$5,040 in 1975 would have \$1,260 of social security benefits withheld. Under the Council's proposal, this individual would have only \$840 withheld, corresponding to a $\frac{1}{3}$ reduction in the burden of the retirement test. The table below illustrates the effect in 1975 of the proposed reduction in withholding rates for earnings in the second level. The percentage reduction in the amount withheld is greatest at the lower level of earnings, where the needs of social security benefit recipients may be presumed to be greater.

Annual earnings	Withholding under present law	Withholding under proposed liberalization	Percentage reduction in amount withheld
\$2,520	0	0	-----
\$5,040	\$1,260	\$840	33.3
\$7,560	2,520	2,100	16.7
\$10,080	3,780	3,360	11.1

It is estimated by actuaries of the Social Security Administration that this liberalization of the withholding rate would increase the cost of the program by an average of 0.04 percent of taxable payroll over the next 75 years (about \$0.6 billion for months in 1976, the first full calendar year).

4. ELIMINATE MONTHLY MEASURE OF RETIREMENT

The Council recommends that the monthly measure of retirement be eliminated so that the retirement test would be based solely on annual earnings. The monthly measure should be retained, however, for the first year for which a cash benefit is received so that a beneficiary (as now) can receive benefits beginning with the first month of retirement, regardless of his annual earnings prior to retirement.

Elimination of the monthly measure from the retirement test would result in savings estimated at 0.02 percent of taxable payroll (about \$0.2 billion for months in 1976, the first full calendar year).

The present test, with a combined annual-monthly measure of earnings, creates an anomaly by permitting the payment of benefits in some situations where payment is difficult to justify. For example, a beneficiary who earns, say, \$15,000 a year and who works regularly throughout the year has all benefits withheld. A beneficiary, however, who earns the same amount, but works only part of the year, say 8 months, can receive benefits for the remaining 4 months. Also, people who customarily work less than a full 12 months each year (e.g., in seasonal employment) can, upon reaching the age of eligibility for benefits, receive some social security benefits during the year even though their work patterns have not changed and their annual earnings are substantial.

The two changes that the Council has recommended in the retirement test, when taken together, would increase the cost of the program

by 0.02 percent of taxable payroll (about \$0.4 billion for months in 1976, the first full calendar year).

SECTION 5. UPPER AGE LIMIT FOR THE RETIREMENT TEST

Under current law, the retirement test is not applied to individuals over the age of 72. One possibility for liberalizing the impact of the retirement test would be to lower the age at which the retirement test no longer applies. The Council felt that this feature of the law, which represented special considerations, should not be extended by using it as a basis for policy or proposed liberalization of the existing retirement test. Any liberalization of the retirement test should be accomplished by direct changes in the provisions of the test, not by exemptions from the test. Therefore, the Council does not recommend any change in the age at which the retirement test no longer applies.

SECTION 6. TAXES ON EARNINGS AFTER AGE 65

The Council considered suggestions for reducing or eliminating social security taxes on earnings of individuals aged 65 and older. Contrary to common impressions, such workers do receive some benefits from these taxes. Earnings after age 65 can be substituted for lower earnings of earlier years in calculating the average monthly earnings on which benefits are based, thereby increasing the primary insurance amount of the worker when he does retire. (This effect will be lessened if earnings before retirement are indexed as the Council recommends in chapter 3.) Also, some workers may use work after age 65 in covered employment to qualify for social security benefits to which they would not otherwise be entitled. Finally, insured workers receive a 1-percent increase in benefits for each year of delayed retirement after the age of 65. In view of these offsetting factors and of the significant loss of income resulting from eliminating the tax for workers aged 65 and over, the Council decided not to recommend exemption from the payroll tax for workers over 65. However, the Council does believe that these offsetting factors are not widely known and that the Social Security Administration should make efforts to publicize them more effectively.

CHAPTER 5

TREATMENT OF MEN AND WOMEN UNDER SOCIAL SECURITY (WITH RESPECT TO SEX AND MARITAL STATUS)

The requirements for entitlement to dependents' and survivors' benefits that are now applied to women should be applied to men, and benefits should be provided for fathers and divorced men as they are for mothers and divorced women. At the same time, the law should be changed, effective prospectively, so that pensions based on work in employment not covered by social security will be subtracted from dependents' benefits. Other provisions of the social security program which are the same for men and women but which are criticized because they appear to have different effects on men and women (or different effects based on marital status) should not be changed.

SECTION 1. BACKGROUND

The Council found the treatment of men and women under social security to be a matter of considerable current interest and controversy and directed special attention to this aspect of the program. It was reviewed in depth by a special subcommittee¹ of the Council in the light of the proposed equal rights amendment to the Constitution, recent and anticipated court actions involving equal rights for men and women, and socioeconomic changes, particularly changes in family structure and earnings patterns.

1.1 PENDING EQUAL RIGHTS AMENDMENT TO THE CONSTITUTION

The pending equal rights amendment to the Constitution would provide that "Equality of rights under the law shall not be denied or abridged by the United States or any State on account of sex." To date, 34 States have ratified the proposed amendment. Two of these have since rescinded their ratification, but there is a question whether rescission is constitutional. Only 4 more States, or 6 if rescission is constitutional, need to ratify the proposed amendment by March 23, 1979,² in order for it to become law. Adoption of the proposed amendment would raise serious doubts as to the constitutionality of any provision in the social security law which is different for men and women.

1.2 COURT ACTIONS

In the meantime, the courts are being asked in a number of cases to rule on whether various provisions of the social security law that are different for men and women are constitutional under the due

¹ Members of the Subcommittee were Edward J. Cleary and John J. Scanlon, with Rita R. Campbell as Chairman.

² This is seven years from the date that Congress submitted the proposed amendment to the States.

process clause of the Fifth Amendment. The Supreme Court has not as yet ruled on the constitutionality of any provision of the social security law that is different for men and women. It is of course impossible to predict the outcome of current litigation.

1.3 SOCIOECONOMIC CHANGES

In recent years Americans have been marrying later and having fewer children. Also, the service sector of the economy has been expanding at a faster rate than other sectors, thus providing an expanding number of jobs of the type that women have traditionally held.

These trends have contributed to increases in the number of working women and in the proportion of women in the labor force. In 1973, more than half of all women worked at some time during the year. About 90 percent of all women have worked in paid employment at some time during their lives.

Moreover, family structure has undergone significant changes. Married couples where only the husband works no longer comprise the majority of families. There has also been a substantial increase in numbers of one-parent families, including families headed by women who are unmarried, divorced, separated, deserted, or widowed, and an increase in households that are headed by women. In 1973, 23 percent of all households were headed by women, as compared to 18 percent in 1960.

1.4 COUNCIL CONSIDERATION

The Council gave special attention to those provisions of the social security law that are different for men and women, and to those provisions which are the same for men and women, but are targets for complaints that the program provides differential treatment based on sex or marital status. The Council's findings with respect to the provisions of the law that are different for men and women are discussed in section 2 below, and its findings on differential treatment under provisions of the law that do not differentiate between the sexes are included in section 3 below. The Council recognizes that further changes in family structure may take place which may sooner or later require changes in the social security program beyond those now being proposed by the Council.

SECTION 2. EQUAL RIGHTS FOR MEN AND WOMEN

In general, the provisions of the social security law that are different for men and women should be made the same for both in a way that is consistent with the purpose and principles of the social security program. Specifically, the one-half support dependency requirement in present law for entitlement to husband's and widower's benefits should be eliminated, and for any category of women entitled to secondary benefits the corresponding category of men should be entitled to the benefits on the same basis.

In light of the proposed equal rights amendment, court decisions in sex discrimination cases not involving social security, and socio-

economic changes, the Council believes it would be desirable to act now to change the provisions of the social security law that are different for men and women. These changes should be made in a way most consistent with the purposes and principles of the social security program rather than as the result of court decision that might not offer such consistency.

2.1 DEPENDENCY REQUIREMENTS

To become entitled under present law to a husband's or widower's benefit based on a wife's earnings, a man must prove that he was receiving at least one-half of his support from his wife when she retired, became disabled, or died. There is no such requirement in the law for women for entitlement to a wife's or widow's benefit based on her husband's earnings.

Benefits are provided for a wife or widow without a specific test of support because it has been thought reasonable to presume that a wife or widow is dependent on her husband's earnings for support and that she loses support or a potential source of support when the husband's earnings are cut off.³ Men, on the other hand, are not generally dependent on their wives for support, and the presumption of dependency that was thought reasonable for a wife or widow has not seemed to be reasonable for a husband or widower. Present law therefore requires a man to establish that he was actually supported by his wife in order to get benefits as her dependent.

The dependency requirements in present law for entitlement to spouses' and surviving spouses' benefits should be made the same for men and women without providing the benefits on the basis of any presumptions as to the dependency of women on men or of men on women. At the same time, the necessity of innumerable detailed investigations of personal circumstances and individual determinations of dependency for both men and women, as would be necessary if women were required to prove dependency as men now do, should be avoided. Accordingly, the Council recommends that the one-half support requirement in present law for entitlement to husband's and widower's benefits be eliminated and that secondary benefits under social security be provided for both men and women under the implied test of dependency in present law for women.

As under present law, a spouse or surviving spouse whose primary benefit as a worker equals or exceeds the secondary benefit as a dependent would be entitled only to the primary benefit. A person entitled to a primary social security benefit lower than the secondary social security benefit would continue to get the primary benefit plus the difference between it and the amount of the secondary benefit.

The law should be changed so that a pension based on work in non-covered employment would affect entitlement to and the amount of secondary benefits under social security in the same way that a primary social security benefit does.

Under present law it is possible for a wife who works in employment not covered by social security to get a full worker's pension based

³ There has always been an exception to this presumption if the wife or widow is entitled on the basis of her own earnings to a benefit larger than her wife's or widow's benefit; in this situation, the wife's or widow's benefit is not payable.

on her noncovered work plus the full amount of the wife's or widow's benefit payable on the basis of her husband's earnings under social security. Generally men cannot get a spouse's or surviving spouse's social security benefit in addition to a pension from noncovered employment because they generally cannot meet the one-half support test. However, with the elimination of the one-half support requirement, as recommended by the Council, it would be possible for both men and women who were not dependent on a spouse's earnings for support and who receive benefits as workers under a pension system based on work not covered under social security to get a spouse's or surviving spouse's benefit under social security. The Council finds that the payment of spouse's and surviving spouse's benefits under such circumstances is contrary to the dependency basis for such benefits.

Accordingly, the Council recommends that the law be changed to prevent the payment of spouse's and surviving spouse's benefits in such cases. Effective prospectively, periodic payments based on a person's work in employment not covered by social security, should be subtracted from any social security dependents' or survivors' benefits for which that person may be eligible.

This change would have no effect on eligibility for, or the amount of, a worker's primary social security benefit. Also, under the proposal, as under present law, nonsocial security pensions from work covered under social security would not affect entitlement to or the amount of secondary social security benefits. In such cases it would be assumed that the pension is designed to be supplementary to social security.

2.2 BENEFITS FOR FATHERS

Present law provides benefits for the wife of a worker entitled to old-age or disability insurance benefits (and the widow or surviving divorced wife of a deceased worker) regardless of her age if she has in her care a child who is under age 18 (or over age 18 and disabled) and entitled to child's benefits on the basis of the worker's earnings. There is no provision in the law for the payment of benefits to fathers in like circumstances.

The Council recommends that benefits be provided for fathers on the same basis as benefits are provided for mothers. With the earnings test applicable to fathers, as it now is to mothers, benefits for fathers, and thus equal rights for men and women in this benefit category, can be provided at relatively little additional cost to the program. It is expected that only about 15 thousand men would qualify for father's benefits when they first become payable. If the earnings test were not applicable, many more men would qualify for father's benefits, and the cost of providing benefits to fathers would be substantial.

2.3 BENEFITS FOR DIVORCED MEN

Under certain circumstances an aged divorced wife or aged or disabled divorced widow can get a wife's or widow's benefit based on her former husband's earnings. There is no provision in the law for the payment of husband's and widower's benefits to divorced men in like circumstances.

The Council recommends that benefits be provided for divorced men on the same basis as benefits are provided for divorced women.

The cost of providing these benefits is negligible. Only about 2 thousand men are expected to qualify for these benefits when they first become payable.

2.4 ALTERNATIVES CONSIDERED ⁴

The Council also considered, but did not adopt, requiring women (and fathers and divorced men) to meet the one-half support test that husbands and widowers have to meet under present law. This approach, like the one recommended by the Council, would prevent the payment of spouse's and surviving spouse's benefits under social security to nondependent men and women whose primary employment was in jobs not covered by social security. The Council recognizes that adoption of the proposal to treat a pension earned in noncovered employment as though it were a primary social security benefit would reduce wife's benefits for some working wives who are approaching retirement age and who will be eligible for pensions based on noncovered employment. On the other hand, application of a one-half support requirement to wives and widows could have as many or more or more adverse effects on people's retirement expectations.

Also, a proof-of-support requirement for women as well as men would substantially increase the administrative complexity of the program and would require large numbers of dependent women to establish dependency on the husband in order to get exactly the same benefits they can get under present law. The approach recommended by the Council would make it possible for men who are actually dependent to get dependent's or dependent survivor's benefits without making such benefits available to men and women who receive pensions from noncovered employment and who were not dependent on the insured worker.

Another approach considered by the Council was the gradual elimination of dependents' benefits or dependent's and dependent survivor's benefits for spouses; however it was not thought that socioeconomic changes warranted such a significant deliberalization in the program, and it was considered that it would be unrealistic to propose such a deliberalization.

2.5 BENEFIT ELIGIBILITY AND BENEFIT COMPUTATION

The benefit eligibility and computation provisions of present law are the same for men and women reaching age 62 after 1974 but are different for men and women who reached age 62 in 1954-1974. The Council does not recommend any change in these provisions since they are the same for men and women reaching age 62 now and in the future. Also, to provide the same computation for men who reached age 62 before 1975 that was provided for women would be very costly, estimated on a retrospective basis at \$1.8 billion a year for the next several years, and still as much as about \$1.5 billion a year even 10 years from now.

⁴ See statement by Mrs. Campbell.

SECTION 3. SOCIAL SECURITY PROVISIONS THAT DO NOT DIFFERENTIATE ON THE BASIS OF SEX

3.1 BENEFITS FOR WORKING MARRIED COUPLES ⁵

Under present law a married couple both of whom worked and paid social security taxes may get less in total benefits than a couple where only one member worked and paid taxes and whose earnings under social security were the same as the first couple. The Council's Subcommittee on the Treatment of Men and Women recommended a proposal that would assure that two-earner couples with significant attachment to the labor force would always get at least as much in benefits as single-earner couples with comparable covered earnings. Under the Subcommittee's proposal such working couples who become entitled to benefits in the future would have the option of receiving retirement benefits based on their combined earnings (with the combined earnings in any year not being permitted to exceed the maximum taxable earnings for an individual). Since higher benefits than under present law would be provided for the couples affected, the proposal could be viewed as providing a larger return on the contributions paid by a working wife with relatively low earnings whose husband also had relatively low earnings. Thus, the proposal would respond, in part, to the complaint of some married women workers that they do not get a return for their own contributions when the wife's benefit, based on the husband's earnings, exceeds her own retirement benefit.⁶

The Council does not endorse the principle of providing benefits based on a married couple's combined earnings. A basic rationale for such proposals is that couples who have paid similar contributions should get similar benefits. However, in an earnings-related social insurance system, such as social security, benefits are not directly proportional to contributions. Further, the Council notes that there is a point beyond which it is difficult to justify adding complex exceptions to the social security law in the interest of providing benefits in direct relation to contributions for special groups.

Also, proposals to base benefits on a couple's combined earnings have a substantial cost—even the proposal with rather limited applicability recommended by the Subcommittee has an estimated average long-range cost of 0.20 percent of taxable payroll. (The proposal would cost about \$4 million in 1976, and more in later years.) A further consideration is that combined-earnings proposals would treat married working couples more favorably than two single workers who have the same amount of covered earnings as the married couple, and, in so doing, would further increase the extent to which the value of the protection afforded married workers exceeds that of single workers.

⁵ See statement by Mrs. Campbell.

⁶ The Council notes that the Subcommittee also considered and rejected a proposal to provide a married worker in all cases some or all of the spouse's or surviving spouse's benefit in addition to his or her primary benefit. The Council is in full agreement with the Subcommittee's decision. Such a change in the law would create inequities, and the very substantial increase in social security contributions that would be required to pay for the additional benefits would apply not only to married people but also to single people, who would derive no additional protection from it. (The cost of a proposal to pay a woman the full wife's or widow's benefit in addition to her own retirement benefit is estimated to be \$9-10 billion above present law in the first full year; if comparable provision were made for husbands and widowers, the cost would be substantially higher.)

3.2 IMPUTED EARNINGS FOR HOMEMAKER SERVICES

The social security law should not be changed to provide earnings credits to homemakers for work done in and around the home for which no earnings are received, or to permit people to pay social security taxes with respect to such work in order to obtain credits.

There is of course an economic value, however difficult to assess, to the work that women and men do in and around the home, and there is a loss when such work ceases. However, no wages are paid for such work, so there is no loss of earned income that occurs when the work stops, as there is when a wage earner retires, becomes disabled, or dies.

Social security is an earnings-replacement program. Its function is to replace, in part, earnings from work that are cut off by retirement in old age, disability, or death. It would be contrary to the nature of the social security program to provide for the payment of social security benefits in cases where no loss of earnings occurs, and the Council believes that it would be undesirable to change the nature and function of the social security program by providing for the payment of benefits in such cases. In addition, any proposal relating to imputed earnings raises serious questions of equity and administrative feasibility.

3.3 SPECIAL MINIMUM BENEFIT

The Council considered a proposal recommended by the Subcommittee on the Treatment of Men and Women to reduce from one-fourth to one-sixth of the prevailing contribution and benefit base the dollar requirement for a year of coverage after 1950 for purposes of the special minimum benefit provision. (Under the law a worker may get a special minimum benefit equal to \$9 multiplied by the number of his years of coverage under social security in excess of 10 and up to a maximum of 30 if that benefit exceeds his regular earnings-related benefit.) The Subcommittee report states that the recommended change was intended to "improve the protection afforded under social security to regular but low-paid workers, the majority of whom are women. . . ."

The Council recommends no change in the special minimum benefit provision. While relatively fewer women than men may be able to qualify for the higher special minimum benefits, this difference results from the fact that women in general have had lower earnings than men. To the extent that the difference in earnings between men and women is the result of discriminatory treatment in the labor market, this difference will be rectified as greater equality between the sexes in employment opportunities, pay scales, etc., is achieved.⁷

Also, since special minimum benefits are not automatically adjusted to increases in prices while regular earnings-related benefits are, within a short period of time the latter will be larger in all cases than the

⁷ By Mrs. Campbell. I do not anticipate that this difference in earnings between men and women will be rectified in the near future. Currently the median annual wage of full-time working women is 57 percent of that of full-time working men, and this is a ratio which has been falling during the last three years from 60 percent. Although I do agree that in the long run women will increase their earnings relative to men's earnings, this will take time. Currently, and in the decade ahead, more women will wish to enter the labor force and the supply of labor is increasing relative to the demand for labor so that especially during this immediate period of unemployment, women may fare worse rather than better. Only when young women who are entering the labor force will seek occupations and gain employment in those types of work which primarily have been done in the past by males, will the ratio move in favor of women. Occupations in the

special minimum benefits and the provision will phase out. The Subcommittee's recommendation would tend to perpetuate the special minimum benefit provision. The Council believes the provision should be allowed to phase out. This "phase out" will occur as future regular benefit levels rise—reflecting expected increases in general wage levels—and benefits for long-term regular workers under social security generally become sufficient to provide earnings replacement that is reasonably related to their preretirement standard of living.

SECTION 4. OTHER FINDINGS

Words that do not denote gender should be used in the social security provisions of the law wherever it is practical to do so.

The Council believes that words that do not denote gender should be used in the law wherever it is practical to do so, provided no change in the intended meaning of the law would result. For example, where possible it would be preferable for the law to refer to "spouse" instead of to "wife" or "husband", and to "surviving spouse" instead of to "widow" or "widower", etc. The Council understands that there is a general principle of statutory construction that calls for interpreting words in a provision of law which denote the male sex as meaning either sex unless there is something else in the law or in the legislative history of the provision which precludes such an interpretation. The Council agrees that this should be the case where it is not practical to use words that do not denote gender (and, in fact, has followed the practice in this report of using "he" where "he or she" is meant).

(Continued)

United States are either held primarily by men and are relatively high paying or held primarily by women and are relatively low paying.

What percent of the differential between the earnings of men and women is a residual after adjustments are made for such variables as education and interruptions over a life time in attachment to the labor force which later results in different average durations of work experience for women and men, I do not know. There is, however, considerable literature on this. I refer the interested reader to recent issues of the *American Economic Review*, Sept. 1973, their *Proceedings*, May 1974; *Journal of Political Economy*, March/April 1974, as well as to government publications, including the 1973 *Report of the Council of Economic Advisers*, and Hearings before the Joint Economic Committee of Congress on "The Economic Problems of Women," July 10-30, 1973, printed in three parts.

In my considered judgment, a fair summary of the literature is that the difference in earnings between women and men due to discrimination will not be corrected over any relatively short period of time. Further, many women work regularly 30 hours or less per week, as in retail stores and although they are "permanently attached to the labor force," their total annual earnings are not sufficient to give them entitlement for this benefit, enacted in 1972 and designed to help the regular, low-paid worker. I support a reduction in the requirement that annual earnings equal $\frac{1}{4}$ of annual prevailing tax base (currently \$14,100) to $\frac{1}{6}$; that is currently from \$3,700 per year to \$2,350.

CHAPTER 6

OTHER CASH BENEFIT RECOMMENDATIONS

SECTION 1. UNIVERSAL, COMPULSORY COVERAGE

The social security system should be applicable to virtually all gainful employment. Therefore Congress should develop immediately ways of achieving this, giving special attention to those areas of employment in which coordinated coverage under social security and existing staff-retirement systems would assure that benefits are reasonably related to a worker's lifetime earnings and contributions.

1.1 BACKGROUND

The original Social Security Act of 1935 provided old-age insurance coverage only for employees working in nonagricultural industry and commerce—fewer than 6 out of 10 jobs in the paid labor force. While the founders of the social security program recognized the desirability of universal coverage, they foresaw legal problems with respect to compulsory coverage of some groups and expected that there would be great difficulty in securing necessary reports of earnings for other groups. As experience was gained under the program, approaches that would make possible or facilitate coverage for groups that initially posed problems were worked out, and coverage was extended to more and more groups until near-universal coverage was achieved. For example, coverage was extended to regularly employed farm and domestic workers, the nonfarm self-employed (other than professional groups), and some State and local governmental employees (on a group-voluntary basis) beginning in 1951, to farm and most professional self-employed people and additional State and local employees beginning in 1955, and to the remainder of the professional groups (except doctors) and members of the armed forces in 1957. By 1957 the coverage of the program had reached virtually its present stage in relation to the objective of universal coverage.

While about 9 out of 10 jobs are now covered under social security, a few major areas of employment still are not covered, either because the law specifically excludes the employment from coverage or because the law provides for coverage of the employment on a group-voluntary basis and coverage has not been elected for all groups. The Council urges that the Congress move as expeditiously as possible to extend compulsory coverage to these areas of employment.

1.2 PROBLEMS UNDER PRESENT LAW

The existence of sizable areas of employment not covered by social security gives rise to serious inequities in benefit protection—particularly for the many workers who move between covered and non-

covered jobs. Some of these workers get windfall social security benefits based on relatively short coverage under social security while others just miss getting enough coverage to qualify for benefits. Universal coverage would assure all workers of benefits which could be supplemented by pension plans and staff-retirement plans that are designed with the knowledge that social security benefits will also be payable. In this way the total benefits that a worker receives could be rationally related to past earnings.

Despite the fact that only a small proportion of all jobs are not covered by social security, there is still great potential for movement of workers between covered and noncovered jobs, and many millions of workers spend part of their working lives covered under social security and part covered only by a staff-retirement system or not covered by any system. More than 8½ million jobs are still not covered under social security. Of these noncovered jobs, about 2½ million are in Federal employment that is specifically excluded from social security coverage by Federal law because it is covered under the civil service retirement system or one of the smaller Federal staff-retirement systems. (When the social security program began, the civil service retirement system was already well established and the advantages of including Federal employees under social security as well were not then apparent.) About 3½ million of the noncovered jobs are in State and local employment and are generally covered under a State or local retirement system. (Coverage is available to State and local employees on a group-voluntary basis through agreements between the Secretary of Health, Education, and Welfare and the individual States; coverage by agreement avoids legal and other problems relating to Federal-State relationships.) Also, more than 300,000 jobs with nonprofit organizations are not covered by social security, most of which are covered by staff-retirement plans.

The Council is particularly concerned that the existing situation affords workers whose career employment is covered only by a staff-retirement system an unfair advantage over the majority of other workers, who are covered and contribute under social security throughout their working lives. Workers, such as Federal civilian workers, whose major employment is not covered under social security can, through secondary employment, become entitled to social security benefits which are in the lower benefit range but which represent a very high return on the worker's social security contributions. For example, a special study in 1969 showed that more than 40 percent of all Federal civil service retirement annuitants were also drawing social security benefits and about one-third of these dual beneficiaries received social security benefits based on the minimum primary insurance amount. Benefits in the lower benefit range are heavily weighted because they are intended for people who have had low average monthly earnings over a working lifetime. Although the wages of many workers in noncovered employment are relatively high and many such workers qualify for substantial staff-retirement benefits, these workers are likely to have artificially low average monthly earnings under social security. (This is because for social security purposes earnings are averaged over a substantial number of years and the workers in question usually have covered earnings in relatively few years.) In many instances the benefits that they

qualify for under social security when combined with the benefits they qualify for under the civil service retirement system (or another system that embraces employment not covered by social security) are high in relation to their earnings and contributions; in some cases the combined monthly benefits exceed previous pay. The cost of the windfall social security benefits payable in such situations must be borne by all covered workers and their employers.

In addition, there are opportunities for windfall benefits for entire groups of State and local employees because of the special provisions for social security coverage of employment for State and local governments on a group-voluntary basis. Coverage for State and local employment may be terminated after coverage has been in effect for 7 years, and in recent years coverage has been terminated for some State and local groups. It is possible for a group to select a termination point when most of its members have qualified for continuing social security protection, including eventual eligibility for Medicare protection. Such terminations of coverage should not be permitted since they, too, impose an unfair additional cost on all who are regularly covered under social security. The Council notes that the basis for not making coverage compulsory for State and local employees is being reexamined by the Social Security Administration in light of recent legal decisions in this area concerning the immunity of the States from Federal taxation.

1.3 RECOMMENDATIONS

Before deciding to recommend universal coverage under social security, the Council considered other approaches for dealing with the windfall benefits problem in cases where the person is also entitled to a staff-retirement pension based on work that is not covered by social security. For example, consideration was given to recommending offsets in social security benefits, or a change in the method of computing social security benefit amounts, to take account of the staff-retirement pensions.¹ The Council concluded that, because these alternatives represent piecemeal and usually complicated approaches to the problem, they would not achieve equitable results and would be difficult to administer.

Extending social security coverage on a mandatory basis to Federal civil service employment and noncovered State and local employment would provide coverage for about 6 million additional jobs and would over the long run eliminate the payment of windfall social security benefits to workers in such employment. Contributions would exceed benefit payments by large amounts shortly after extension of coverage but such balances would decrease as benefits based on newly covered employment rose rapidly in the future. It is estimated that over the long-range future, extension of coverage to such employment would result in a reduction in costs of about 0.25 percent of taxable payroll to the social security cash benefits program and 0.10 percent to the hospital insurance program.

The Council recognizes that many difficulties must be overcome if the objective of universal, compulsory coverage under social security

¹ By Mr. Arnold, Mr. Cleary, and Mrs. Norwood. We feel that this statement is inconsistent with certain recommendations made by the Council.

is to be achieved. However, it is of great importance from the standpoint of assuring good basic protection for all workers on an equitable basis that all jobs be compulsorily covered under social security. The Council therefore urges the Congress to act promptly to extend coverage to the noncovered areas of employment.

SECTION 2. THE MINIMUM BENEFIT

The Council notes the changing function of the minimum benefit and recommends that, for people who start getting benefits in the future, the minimum initially payable should be held constant at the level in effect at the time the proposal is adopted. As under the law now, all benefits, including those at the minimum level, should be kept up to date with prices after people become entitled to benefits.

2.1 PRESENT LAW

In its review of the present social security benefit structure and its consideration of proposals to stabilize replacement rates, the Council gave particular attention to the minimum and near-minimum benefit levels. Under the law, the regular minimum benefit (now \$93.80) will, like other benefits, be increased for both current beneficiaries and future beneficiaries as the Consumer Price Index rises in the future. Benefits based on this minimum are payable on the basis of average monthly earnings under social security of \$76 or less—an average so low as to indicate weak attachment to the labor force. The minimum of \$93.80 replaces at least 123.42 percent of the average monthly earnings on which it was based.² And the percentage replacements of average monthly earnings at the minimum will continue to increase for future beneficiaries as the Consumer Price Index rises, if present law is not changed.

2.2 ISSUES

The Council has reviewed the history of the social security minimum benefit and the changing characteristics of those who get benefits based on the minimum and has concluded that, in the future, the relative significance of the minimum benefit should be reduced.

A minimum benefit of \$10 was originally adopted in the interest of administrative efficiency and to avoid the public relations problems that would arise if very small monthly benefits were paid. The minimum benefit has, over the years, been increased more than twice as much as benefits generally have increased. In large part, disproportionate increases have been made on the basis of arguments related to the "inadequacy" of the minimum benefit for meeting individual needs. Whatever validity such arguments may have had, the Council believes that there is a limit beyond which there should not be included in the earnings-related social security program benefits that exceed the earnings on which they are based. The Council also believes that the enactment of the supplemental security income program should have made it unnecessary to increase the social security minimum benefit to promote social welfare objectives and

² Since the minimum is payable at all average monthly earnings levels below \$76, in many cases it is a much higher percentage of average earnings.

recommends that future efforts to assure minimum adequate income be channeled through such means-tested programs.

Furthermore, the Council is concerned that benefits at minimum and near-minimum levels are increasingly paid not to people who have substantial attachment to work covered by the social security program but to people who were not primarily dependent on earnings in covered employment during their working years. An ever-increasing minimum increasingly provides a windfall to the latter group and therefore is less justifiable as a social insurance benefit. At the present time (and increasingly in the future) virtually everyone with substantial long-term work in covered employment will qualify for an earnings-related benefit in excess of the minimum. For example, a man retiring at age 65 in 1974 who worked throughout his life at the prevailing Federal minimum wage would have a benefit of \$181.60, almost double the \$93.80 minimum. Even if he had had such earnings over a much shorter period, his benefit would still exceed the minimum.

2.3 ALTERNATIVES CONSIDERED

The Council considered several ways to reduce the significance of the minimum benefit. The alternatives considered included eliminating the minimum benefit, gradually reducing the amount of the minimum, and gradually reducing the highest earnings levels at which the minimum would be payable. Absolute elimination of the minimum benefit—while theoretically reasonable—would adversely affect the retirement plans of many people now approaching retirement. The other alternatives considered were laid aside after the Council decided to recommend fundamental changes in the method of computing benefits (see chap. 3, sec. 3). The Council therefore adopted an approach which will freeze the current benefit table, including the minimum and near-minimum benefit levels, for as long as these benefit levels may prove more generous than those resulting under the revised benefit formula. Thus, in effect, the minimum benefit at initial entitlement would be frozen indefinitely at the level in effect when the change is adopted. This approach is not only least disruptive to individual retirement plans but is also compatible with the Council's recommendation for basic changes in the method of computing benefits. (See chap. 3, sec. 3; and chap. 7, sec. 4.1.)

2.4 EFFECTS OF RECOMMENDATION

The recommendations to freeze the minimum benefit under the present system and to limit replacement rates at low earnings levels under the proposed new system for computing benefits (discussed in chap. 3, sec. 3) will strengthen the wage-related nature of the program in the future, and, at the same time, will not reduce benefit levels below those in effect when the new system is implemented. The Council recognizes, however, the reliance of many beneficiaries today on social security benefits based on low earnings and the need to assure that the purchasing power of benefits for all people, once they have started getting benefits, will be maintained. We, therefore, recommend that all beneficiaries who become entitled to benefits in the future have their benefits kept up to date with the Consumer Price Index once they are on the benefit rolls.

2.5 RELATED CHANGES NEEDED

There are some workers with substantial work histories, but very low earnings (such as domestics, migrant farm workers, and some manual laborers), who depend on their covered earnings when working and for whom minimum social security benefits may be the primary, if not the only, source of retirement income. In order to compensate for the fact that such workers and their dependents and survivors who initially qualify for benefits in the future might get lower benefits under the recommendation than they would get if the present minimum benefit provisions were retained, some alternative source of additional income should be provided for them. The Council believes that a needs-tested program, such as the supplemental security income program, is appropriate for providing additional income for such workers. However, a substantial proportion of the people affected by the recommendation will be between ages 62 and 65 when they apply for social security benefits and, therefore, will not be eligible for supplemental security income payments. In order to avoid creating new hardships, it is essential to assure that those who depend on minimum social security benefits be provided for either through the supplemental security income program or by some other means. One change in the supplemental security income program the Council believes should be considered is lowering from 65 to 62 the age of eligibility for people who cannot qualify for payments on account of disability or blindness.

SECTION 3. OLDER DISABLED WORKERS

A worker aged 55 or older who cannot meet the general test of disability in present law should be eligible for reduced social security disability benefits if he is otherwise eligible and can no longer engage in substantial gainful activity requiring skills or abilities comparable to those required in any gainful activity in which he has previously engaged with some regularity and over a substantial period of time.

3.1 PRESENT LAW

The definition of disability in the social security law that is applicable to all workers except older blind workers is, in effect, a test of total disability: inability to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment that has lasted or is expected to last at least 12 months, or to result in death. An exception is provided for blind workers aged 55 and older, who can qualify for benefits under a less strict test of disability. Under this test, a blind worker aged 55 or older is considered disabled for social security purposes if, because of blindness, he can no longer engage in substantial gainful activity requiring skills or abilities comparable to those required in any gainful activity in which he has previously engaged with some regularity and over a substantial period of time.

3.2 ISSUES

The present general definition of disability, while appropriate for younger workers, is unrealistic when applied to older workers. A

severe, but not totally disabling, impairment can have virtually the same impact on an older worker as does total disablement on a younger worker. Many workers who drop out of the labor force in their fifties and early sixties do so because of impairments that are not yet totally disabling for all work but that prevent them from continuing in the kinds of work they have done regularly. In many instances, they cannot, as a practical matter, establish new vocational skills because of advanced age. Unable to qualify for social security disability benefits, they may have little or no regular income.

3.3 EFFECT OF RECOMMENDATION

The Council has concluded that the test of disability now applicable to older blind workers should be extended to other older handicapped workers without regard to the cause of disability. Under this test, a medically impaired individual who is otherwise eligible and who could no longer do his previous work would be considered disabled if his major skills or abilities could not be transferred to related jobs or fields. For example, an age-55 truck driver who lost his job because he could no longer drive a truck would be found to be disabled if he had no other major skills or abilities that could be transferred to another job. On the other hand, if the same person were still able to drive but lost his former job because he was not able to do heavy lifting which was a requirement of his job, he would not be disabled since he could transfer his driving skills to another job.

The aim of the Council's recommendation is to provide disability benefits in those situations where the older handicapped worker cannot realistically be expected to be able to work, considering his impairment and the skills he has developed from past work. The Council is equally concerned with the desirability of maintaining incentives for older handicapped workers to use already-developed skills. The Council believes that the definition of disability it is recommending for older workers, which is the same as that recommended by the 1971 Advisory Council, will provide needed protection for older handicapped workers without interfering with work incentives or subjecting the program to unwarranted increases in program costs.

3.4 ALTERNATIVES CONSIDERED ³

In arriving at the recommendation for a modification in the definition of disability for older handicapped workers, the Council was sensitive to the fact that the cost of the disability insurance program has been increasing rapidly in recent years and has substantially exceeded the estimated cost. For these reasons the Council rejected a definition of disability for older handicapped workers that would be less strict than the one now applicable to the blind. Under this definition, a worker would be eligible for benefits if he were so disabled that he could no longer engage in substantial gainful activity in his last regular occupation. This alternative would be substantially more expensive than the definition that is being recommended.

³ See statement by Mr. Arnold, Mr. Cleary, and Mrs. Norwood, statement of Mr. Danstedt, and statement of Mr. Byrnes, Mr. Faulkner, Mr. Scanlon, and Mr. Smith.

3.5 COST AND NUMBER AFFECTED

As a way of reducing the cost of the recommended definition of disability for older workers, the Council recommends that the benefits paid under the definition be equal to 80 percent of the full benefits that a disabled worker receives if he meets the regular definition of disability in the law. (The benefit rate would be the same as that now payable to workers who receive retirement benefits starting at age 62.) Such a provision would have a significantly lower cost than would a proposal which provided for full-rate benefits.

As an additional measure to keep down the cost, the Council recommends that Medicare protection should not be made available to those older disabled workers who would qualify for benefits only under the less stringent definition being proposed. (Under present law, a person who has been entitled to disability benefits for 24 months becomes entitled to Medicare protection.) The Council recommends that Medicare protection for this group should be considered in conjunction with congressional deliberations on the issue of national health insurance.

The Council's recommendation for providing benefits to older disabled workers who are not eligible under present law, with the recommended cost-reduction measures, would have a long-range cost of 0.13 percent of taxable payroll (about \$0.7 billion for months in 1976, the first full calendar year).

3.6 OTHER CONSIDERATIONS

The Council is aware of the concerns expressed in the July 1974 Committee Staff Report on the Disability Insurance Program.⁸ In that report, the staff expressed the view that "sounder information is needed on the ramifications of the current definition" and recommended that "if the current Advisory Council does make legislative recommendations in addition to studying the actuarial condition of the program, an examination of the definition of disability would appear essential." While the Council did acquaint itself with the way in which the present definition is applied and with certain operating experiences under that definition, it has not been able to undertake, in the limited time available, a definitive study of experience under the disability program. The Council took note of the fact that the Committee on Ways and Means appointed an *ad hoc* subcommittee to review the problems and issues mentioned in the Committee Staff Report. The Council's recommendation to fill the present gap in disability protection for older workers, together with its recommendation that financing be provided to meet the cost of the change, will not aggravate the problems mentioned in the Committee Staff Report and may ameliorate some of them.

SECTION 4. EFFECT OF SOCIAL SECURITY ON MINORITY GROUPS

The terms and benefits of the social security program are uniformly applicable to all individuals covered by the program regardless of race or ethnic identification. Because racial and ethnic groups may have

⁸ Prepared by the Staff of the Committee on Ways and Means of the House of Representatives.

different economic, demographic, and sociological characteristics, however, the program may have different impacts on the various groups. The Council concerned itself with the question of how minority groups fare under social security and found that the available data were inconclusive. The Social Security Administration is conducting studies bearing on this subject, and the Council recommends continuing study so that when changes in social security are being considered, the Congress and future Advisory Councils will have before them adequate information on the program's impact on minority groups.

As an example, one suggestion often heard is that since the longevity of blacks is less than that of whites, the social security program should be adjusted to take this difference into account. It is not clear, however, to what extent other provisions of the program such as survivors benefits, disability benefits, and the weighting in favor of low-paid workers in the benefit formula may offset whatever disadvantage nonwhites may experience under social security because of lesser longevity. Further data and analysis are necessary before an adequate evaluation can be made of proposals to modify social security to compensate for the lesser longevity of nonwhites or other definable groups.

SECTION 5. PROGRAM SIMPLIFICATION

When future changes in the social security program are considered, the effect of these changes from the standpoint of program simplification should be taken into account. Continuing attention should be given to simplifying the program, subject to considerations of equity and cost.

5.1 BACKGROUND AND DISCUSSION

When the social security program started in 1937 it provided only retirement protection for workers and covered only jobs in commerce and industry—less than 6 out of 10 jobs. Today, 9 out of 10 jobs are covered, and the program provides not only retirement insurance but also survivors and disability insurance and Medicare. The history of the program has been characterized by many changes and continuous growth. Originally there was only one category of beneficiaries; now there are many. The forms of protection added, the extension of coverage to additional groups, the additions and refinements made to the beneficiary categories, and numerous other changes have made the social security program more effective but also increasingly complex.

Complexity is also a byproduct of the continuing concern of the Congress that the social security program be as equitable as possible. This concern has prompted the enactment of special provisions for individual groups. For example, the child's benefits provisions have been amended over the years to provide benefits for special groups of children who, it was believed, should be protected under the program since they are dependent on the worker, and there are different eligibility and dependency requirements for each group of children.

The social security law now has so many ramifications and so many complex provisions that few people covered under social security understand the nature and extent of the protection provided. This

lack of understanding can frustrate individual efforts to plan retirement and to work toward building additional protection to supplement social security. The complexities of the program have also made its administration increasingly difficult.

The Council recognizes the difficulties involved in developing legislative proposals to simplify the social security program which would avoid substantial cost and yet not reduce benefits for some beneficiaries. Many legislative changes that would promote better understanding of the program and facilitate administration would unnecessarily raise benefit levels for some groups of beneficiaries. The increased costs that would result would have to be borne by all employers and workers who participate in the social security program. Other proposals for simplification which would have no costs or which would result in a savings to the program would significantly liberalize eligibility requirements or benefit levels for some beneficiaries.

5.2 CONCLUSION

When considering various changes in the social security program, the Council has kept the goal of program simplification in mind, and some of the proposals the Council is recommending elsewhere in this report would have the ancillary effect of simplifying the provisions of the social security program. The Council's recommendation that the monthly measure under the retirement test be eliminated would simplify the administration of the retirement test provisions. The method of computing benefits the Council is recommending would, over the long run, be a desirable simplification over the present method. Also, in addressing the issue of equal treatment of men and women under the program, the Council has chosen to recommend that the dependency test be eliminated for eligibility for husband's and widower's benefits instead of recommending the addition of a dependency test for wife's and widow's benefits. The Council notes the work which the Social Security Administration has done in devising possible program simplifications (particularly the proposals developed by the Social Security Administration Task Force on Program Simplification) and urges that continuing attention be given to achieving the objective of simplifying the social security program with due consideration for equity and cost.

The Council recognizes that the Congress, as it has in the past, will continue to take into account considerations of equity and the needs of special groups when making changes in the social security program. The Council recommends, however, that when future changes are considered the effect of these changes in simplifying or complicating the social security program also be taken into account. In addition, the Council suggests that the Congress take into account the impact on the Social Security Administration's responsibilities for administering the social security program in future decisions as to whether or not to broaden the Social Security Administration's responsibilities to embrace the administration of programs that are not part of social insurance.

SECTION 6. FREQUENCY OF COST-OF-LIVING ADJUSTMENTS IN SOCIAL SECURITY CASH BENEFITS

Under present law, social security cash benefits can be increased automatically each June if the Consumer Price Index has risen by 3 or more percent between specified base measuring periods. Even during periods of rapid inflation, the automatic benefit increases can occur no more frequently than once a year. Members of the Council are concerned about the short-range impact of rapid increases in the cost of living on social security beneficiaries and the difficulties many of them may face as the purchasing power of their benefit dollar is eroded.

The Council notes that in 1972, when the provision for automatic adjustment of benefits was enacted, the Congress expressed the intent that the purchasing power of social security beneficiaries should at least be maintained. The Council also notes that, in recognition of the rapidly rising prices during the past 2 years, the Congress modified the automatic adjustment provisions in 1973 to provide benefit increases sooner than called for under the 1972 law.

The Council also recognizes that proposals for more frequent adjustments would raise questions of equity between workers and beneficiaries particularly when, in times of very rapid inflation, wage increases may lag behind price increases for a year or longer. And it is recognized that such proposals could have significant technical and administrative ramifications, as well as cost effects. In the limited time available to this Council, it was not possible to explore fully and analyze all the implications of alternative proposals to improve the responsiveness of the automatic benefit adjustment provisions to rapid inflation.

In view of congressional intent and the fact that most beneficiaries have only a small margin for reduction in purchasing power, the Council recommends that the Administration and the Congress give consideration to proposals that would, in times of especially rapid inflation, keep beneficiaries' purchasing power more current than is possible under the present system of annual adjustments.

CHAPTER 7

FINANCING

The Chairman of the Council appointed a Subcommittee on Finance¹ to review the financial aspects of the social security system. It was assisted by five independent professionals, two economists and three actuaries. In the limited time available, the review was necessarily concentrated on the OASDI program because it faces financing difficulties. The report of the Subcommittee will be summarized in this chapter, but for additional information on any particular item, the reader is referred to the Subcommittee's detailed report which is attached as Appendix A.

SECTION 1. BASIC CHARACTERISTICS OF OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE PROGRAM

1.1 CURRENT COST FINANCING

The financing of the OASDI system is based on the "current cost" method. Under this approach, no fund is created during the life of a worker from which his benefits are ultimately paid. Instead the social security taxes he pays are immediately paid out by the government to persons who are already beneficiaries. His own benefits will be paid from taxes that are collected in the future from persons who are then working. The tax rate is set so as to provide tax receipts that approximate current expenditures. In essence, the plan transfers money from one generation to another with the amount taken from the one generation being measured by the other generation's benefit requirements.

The current cost method would be unacceptable for a private pension plan, but it is a sound alternative for OASDI, because the government has the continuing power to tax future workers in order to pay benefits in the future to those who are now working. If OASDI were funded, in the actuarial sense, by creating a fund of one or two trillion dollars, that fund would have to be invested.² The largest part would almost certainly go into government bonds because they are considered to be the safest investment. The value of such bonds, however, depends on the power of the government to tax in the future. There would be, therefore, no really greater security behind the system than there is today, but the funding would have a very real effect on capital formation in this country.

In fact, even with the current cost method, the OASDI system has affected the capital formation of the country and will continue to

¹ Members of the Subcommittee were Rudolph T. Danstedt, Elizabeth C. Norwood, and J. Henry Smith, with J. W. Van Gorkom as Chairman.

² By comparison, the Federal debt outstanding at the end of fiscal year 1975 held by the public is estimated to be about \$360 billion.

affect it in ways that are not clearly understood at this time. Since the formation of adequate capital for the nation's needs is a currently pressing problem, the Council strongly recommends that a study of the relationship between the financing of the social security system and capital formation be made at the earliest possible time.

1.2 MEASURING LONG-RANGE COSTS

In discussing the "cost" of the OASDI system, the use of numbers in absolute dollars is of little help, because there are constant changes in the number of workers, beneficiaries, wage and benefit levels and other factors. Throughout this report, therefore, we will be expressing "cost" as a percentage of total covered earnings, meaning earnings subject to the OASDI tax. This is the measure of cost that will be used herein because it focuses attention on the size of the burden to be borne by each individual taxpayer and employer. As an example, the cost of the system in 1974 was 10.67 percent of covered earnings. Since total covered earnings in 1974 approximated \$600 billion, absolute cost of the system in that year was around \$64 billion.

1.3 OASDI TAX RATES

The current tax rate for OASDI is 9.9 percent, payable on all earnings up to \$14,100.³ The total tax is split equally between the employer and employee, with each paying 4.95 percent. (To this is added .9 percent for hospital insurance making a total social security tax of 5.85 percent borne by each.) The cash benefits tax rate for the self-employed was originally established at a level of 150 percent of the employee's tax. However, in recent years it has been frozen at 7 percent.

1.4 WEIGHTED BENEFIT STRUCTURE

While the tax rate for all employees is the same, the benefits are not equal. They are weighted in favor of lower-paid workers and those with dependents. The low-paid worker receives a benefit that is a higher percentage of his (or her) average earnings than does the higher-paid employee, even though the latter receives a larger absolute amount. This weighting of the benefit schedule represents society's recognition of "adequacy" as a criterion of the plan, and is a departure from the strict principle of individual equity. Another such social concept is found in the fact that a married worker receives certain protection for his dependents without paying any more premium than a single worker who receives no such protection.

The entire social security program is necessarily a blend of social goals and individual equity. Maintaining the proper blend is very important if we are to sustain the workers' support of the plan. To date, most workers feel responsible for the system because, while aware of the social weighting within the program, they still view their protection as being reasonably related to the taxes they pay. This attitude is important to the success of social security. It becomes an important factor when considering the introduction of additional welfare-type benefits or methods of financing from general revenues.

³ The \$14,100 applies to earnings of 1975. The amount rises each year in accordance with the increase in average wages in covered employment.

SECTION 2. AUTOMATIC ADJUSTMENT TO INFLATION

In the 40 years since the program was created, Congress has voted many raises in benefits. Whenever such raises were enacted, the tax rate was usually also increased to help cover the additional cost. The maximum amount of wages subject to tax has likewise been raised from time to time.

2.1 BENEFITS

In 1972, Congress made a basic change in the system. It modified the *ad hoc* approach and provided that thereafter benefits would increase automatically in accordance with changes in the cost of living, without any action by Congress. The cost of living is to be measured by the Consumer Price Index (CPI). The first such automatic increase is now scheduled to take place for the month of June 1975, with the increase in benefits to be payable in early July.

2.2 TAXES

Congress is relying on the fact that, as prices increase, wages will also increase, thereby raising the total wage base and providing the needed additional revenue to cover the automatic increase in benefits. The social security law provides that whenever benefits are automatically increased, the base for the following year is raised by the amount of the increase in wages in covered employment.

2.3 EFFECT OF WAGE AND PRICE INCREASES ON COST ESTIMATES

Adoption of this automatic method has made the future cost of the system dependent upon future changes in prices and in wages. The cost can no longer be determined on the basis of today's benefit schedule, because it will move up automatically with changes in the CPI. In determining the long-range financial soundness of the system, therefore, estimates of the movements of prices and wages are made for a 75-year valuation period. This long period of time is used because the inter-generational transfers and the impact of the controlling factors are best reflected when measured over a very long time frame.

SECTION 3. 1974 TRUSTEES' REPORT ON THE FINANCIAL CONDITION OF OASDI

3.1 ASSUMPTIONS

In the first part of 1974, the trustees of the OASDI system made their regular actuarial review of the plan and projected its cost over the period beginning with 1974 and ending with the year 2048. Their projections were based on four major assumptions:

1. Wages will increase over the 75-year period at an average rate of 5 percent;
2. The CPI will increase at an average rate of 3 percent;
3. Real wages ⁴ will increase at an average rate of 2 percent;
4. The total fertility rate ⁵ will rise from 1.9 in 1974 to 2.1 by 1985 and remain there.

⁴ Real wages are wages adjusted for changes in the CPI. This factor actually expresses the relationship between the first two assumptions, but it is set out separately because of its importance, the cost of OASDI being very sensitive to this relationship.

⁵ The total fertility rate is the average number of babies born per woman during her lifetime.

3.2 ESTIMATED DEFICIT

Based upon these assumptions, the trustees have computed the cost of the system as set out in Table A, below. For comparison the tax rate presently authorized by law has also been provided:

TABLE A

Calendar year:	Cost, as a percent of taxable payroll required to meet benefits	Combined tax rate of employer and employee under present law
1974	10.67	9.9
1985	10.44	9.9
1990	11.03	9.9
1995	11.25	9.9
2000	11.31	9.9
2005	11.69	9.9
2010	12.69	11.9
2015	14.14	11.9
2020	15.71	11.9
2025	16.97	11.9
2030	17.60	11.9
2035	17.68	11.9
2040	17.68	11.9
2045	17.86	11.9

¹ (2011).

Note: Average cost 13.89 percent. Average tax 10.91 percent.

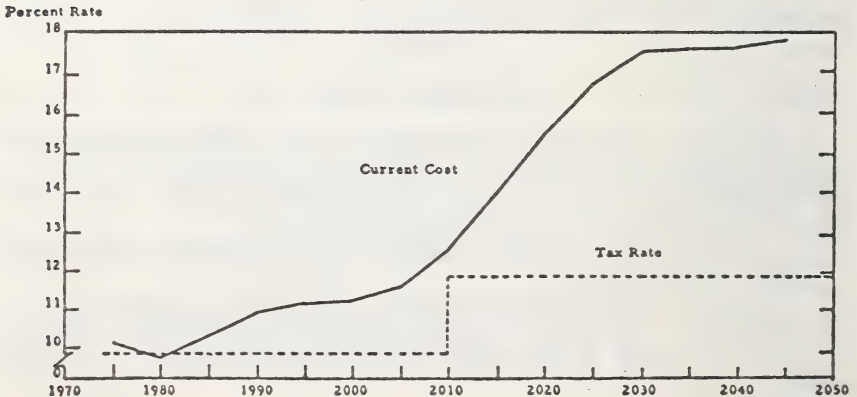
The difference between the costs and the tax rates above represent a financing deficit of 2.98 percent.

3.3 PATTERN OF THE DEFICIT

It is not enough, however, to say that the long-term deficit is 2.98 percent. The "shape" of that deficit is very important. It is clear from Table A that the deficit does not occur evenly over the period. This is a vital factor in determining future tax rates, and it is even more evident in the graphic portrayal below.

PROJECTED OASDI CURRENT-COST AND TAX RATE IN PRESENT LAW, 1975-2045

Both rates expressed as a % of covered earnings



The deficit is the spread between the tax and cost curves. The graph shows that a relatively small amount of the deficit occurs in the next 30 years, but thereafter the deficit increases rapidly.

The most important reason for this shape of the deficit is demographic. Relatively few people were born during the great depression of the 30's. After the war, the total fertility rate rose sharply to a peak of 3.77 in 1957. Thereafter it began to decline and it has recently reached the very low rate of 1.9 which is below the population replacement rate. The trustees have estimated that this rate will gradually rise to 2.1, which is the rate at which the population will eventually stabilize itself, and will remain there indefinitely.

It is this historic birth rate pattern that largely shapes the deficit. The working population has been growing rapidly as the "war babies" have entered the work force, and this will continue for some years. This means that there is a relatively large number of people who will be paying the benefits of a relatively small number of people, and for this reason the cost will not rise materially, even with automatic increases in benefits. After all of the war babies have entered the work force, costs will still rise slowly for a short period during which the relatively small number of depression babies start to draw benefits.

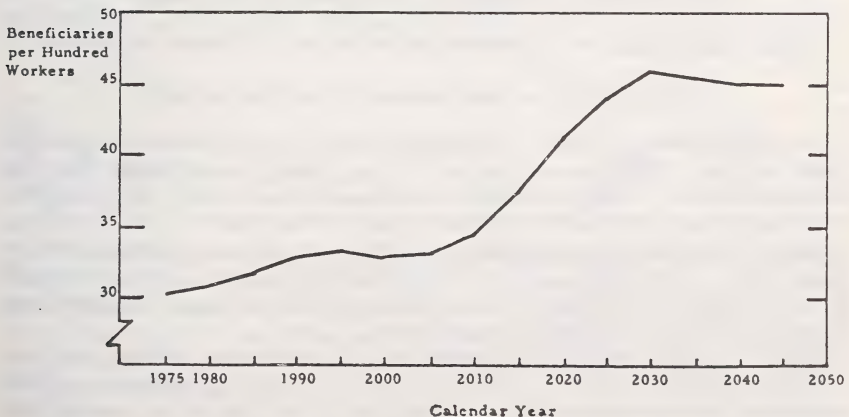
Starting about 2005, however, the process reverses itself. Then the war babies begin to draw social security benefits in ever larger numbers, while the work force is not increasing at a commensurate rate because of the low fertility rate now existing and forecasted for the future.

These demographic changes are reflected in two important statistics:

1. Today there are 30 beneficiaries for every 100 workers.
2. In the year 2030 it is estimated that there will be 45 beneficiaries for each 100 workers.

This situation is more easily grasped with another graph:

PROJECTED OASDI BENEFICIARIES PER HUNDRED COVERED WORKERS, 1975-2045



It is possible, of course, that greater immigration or greater than anticipated participation by women in the work force may solve the problem. If not, this graph suggests that around the year 2005, pres-

tures may well develop to increase the retirement age beyond 65. This would modify the ratio between workers and beneficiaries and reduce the high benefit costs that will otherwise have to be met. Today, of course, the general demand is to *reduce* the retirement age, not increase it, because the work force is expanding.

Obviously the demographic projection has an almost overwhelming effect on the costs of the system. This can be seen in the table below where the 2.98-percent deficit has been broken down into its components:

Table B

	Percent of Taxable Payroll
Actuarial balance of OASDI estimated in late 1973.....	— .51
Effect of subsequent changes in:	
Population assumptions.....	—1.87
Economic assumptions.....	— .19
Disability rates.....	— .21
All other assumptions.....	— .20
	—2.47
New actuarial balance.....	—2.98

The change in population assumptions accounts for 63 percent of the total deficit and 76 percent of the increase in the deficit since the last actuarial review.

3.4 APPRAISAL OF ASSUMPTIONS USED IN THE TRUSTEES' REPORT

The Subcommittee on Finance reviewed the four basic assumptions used by the trustees in arriving at their conclusion of a 2.98-percent deficit. An explanation of the Subcommittee's review is presented in full in their report (Appendix A).

Let it suffice to say that the Subcommittee found reasonable support for the trustees' conclusion, but were of the firm opinion that the deficit is more likely to be higher than lower. The Consultants also reviewed the trustees' four basic assumptions. While not unanimous in their opinions on individual factors, they stated that "we find the Trustees' conclusion is a reasonable indicator of future experience."⁶

3.5 REVISIONS OF THE ESTIMATE OF THE DEFICIT

As this is being written the social security staff is well along in its work on the 1975 trustees' report. It is already quite clear that the assumptions as to wage and price increases in that study will be higher than the 5 percent and 3 percent⁷ used in the 1974 study. It seems possible that new demographic projections may reflect lower fertility rates than those used in the 1974 trustees' report. Thus, the 1975 trustees' report will almost certainly show a significantly higher long-term deficit than is currently projected.

Our primary problem is covering the estimated deficit, but the 2.98 percent, forecasted by the trustees, is not the full amount. There are other factors which add to and subtract from that deficit, and which must be included in any proposed solution. One of these factors is the effect of the unexpectedly high benefit increase for June of 1975.

⁶ See statement of Mrs. Campbell.

⁷ Rates of 6 percent and 4 percent, respectively, were forecasted in February 1975, by a panel of outside consultants employed by the Senate Finance Committee. These higher rates, plus some less optimistic demographic projections, resulted in a conclusion by the panel that the average long-term deficit would be 6 percent.

51

Under the present law, benefits are scheduled to rise automatically with the CPI. The first such automatic increase will occur for the month of June 1975, and will be measured by the rise in the CPI between the second quarter of 1974 and the first quarter of 1975. The trustees originally estimated in early 1974 that such increase would be 4.4 percent. It is now estimated that the increase will be 8.5 percent and this, in turn, will cause an increase of .51 percent of covered wages in the estimated long-term deficit.

It is important to note that this increase in the deficit has an *immediate* impact on the cost of the plan. It is not deferred like so much of the 2.98-percent deficit computed by the trustees. Provision for this addition to the deficit cannot be long delayed.

SECTION 4. COUNCIL RECOMMENDATIONS AFFECTING FINANCING

4.1 STABILIZATION OF REPLACEMENT RATIOS

A "replacement ratio" is the relationship between a worker's initial monthly benefit and the monthly wage he earned just before he retired, died, or was disabled. For example, if a worker earned \$600 per month just before he retired and received a benefit of \$300 per month, his replacement ratio would be 50 percent. Replacement ratios are an important criterion of the effectiveness of an earnings replacement system, and they should be stable, even though benefit levels will continue to rise with wages and prices.

The system at present contains a flaw which can cause replacement ratios to fluctuate widely, both up and down, depending on movements of wages and prices. This problem is explained at length in the report of the Subcommittee on Finance. One example taken from that report will suffice to demonstrate the need for correction. The figures below represent the projected replacement ratios of a low-paid worker, assuming average wage increases of 5 percent a year, and growth in the CPI at various rates:

TABLE C.—REPLACEMENT RATIOS IF WAGES GROW AT 5 PERCENT ANNUALLY

Year of retiring	Annual increases in CPI		
	4 percent	3 percent	2 percent
1975.....	0.615	0.611	0.606
1985.....	.675	.608	.547
2000.....	.843	.657	.511
2025.....	1.299	.799	.489
2050.....	1.647	.855	.445

If the inflation rate is 4 percent, the replacement rate for the low earner will grow from .615 to 1.647, and he will receive a benefit in 2050 that is more than 60 percent above his final earnings level.⁸ On the other hand, if the inflation rate is 2 percent, his replacement rate in 2050 will be only 27 percent of what it would have been under a 4-percent inflation rate.

⁸ If he has a wife over 65 years of age, they will receive a benefit that is 50 percent greater, and this will provide a replacement ratio of 2.47. It should be noted that these replacement ratios are also understated by the effect of income and social security taxes. Social security benefits are not subject to such taxes, but wages before retirement are. The same type of understatement occurs to the extent that there are work-related expenses which are eliminated after retirement.

The above table presents the problem with great clarity. Replacement ratios can move capriciously, either *up or down*, and they can move in a broad range depending upon the movements of prices and wages, two factors over which the system has no control. This is a very undesirable characteristic in the system and was probably not intended.

The cause of this instability is found in the automatic benefit increase mechanism. Whenever the CPI rises under today's system, benefits will automatically rise. The increase in benefits is accomplished, in effect, by raising the entire benefit schedule. This increases the benefits for all persons who are already retired, *but it also increases the future benefits for those who are still working*, because they will eventually obtain the advantages of the higher benefit schedule when they retire. At the same time, however, those who are still working will also receive an increase in wages, and this will increase their average monthly earnings and thereby further increase their future benefits. In other words, the benefit increases for those still working are coupled with the benefit increases for retired persons, and this produces the instability in replacement ratios which is illustrated above.

To correct this flaw requires a new method of computing benefits and the Council has already proposed such a method in Chapter 3, on inflation. Both the old and the new methods are explained in detail in the report of the Subcommittee on Finance.

Briefly summarized, the starting point in computing the benefit of an individual today is the determination of his average monthly earnings (AME) by using the actual taxable earnings for years after 1950 down through the year before retirement occurs. That AME is then applied to a benefit schedule which is set out below:

- 119.89 percent of first \$110.00 of AME;
- 43.61 percent of next \$290.00 of AME;
- 40.75 percent of next \$150.00 of AME;
- 47.90 percent of next \$100.00 of AME;
- 26.64 percent of next \$100.00 of AME;
- 22.20 percent of next \$250.00 of AME; and
- 20.00 percent of next \$175.00 of AME.

As explained earlier, this benefit table is intentionally weighted in favor of the low-paid employee.

The proposed system (sometimes referred to as the "decoupled" system) uses the same earnings for the years after 1950, but it indexes those earnings to the year before the year in which retirement occurs. Let us assume, for example, that a man retires in 1974 at age 65. If he earned \$3,500 in 1960 and the average 1973 covered wage is 80 percent higher than the average 1960 covered wage, then the employee's earnings of \$3,500 will be multiplied by 1.8 and the resulting \$6,300 will be used as his earnings for 1960 in computing his average earnings. These are now referred to as his average monthly *indexed* earnings, referred to as AMIE.⁹

This AMIE will always be higher than the AME, formerly used, and will usually be substantially higher. Therefore, it would be improper to use the schedule of benefit percentages used under today's

⁹ The indexing feature has collateral benefits of its own, in addition to forming a necessary part of the proposed system. These are explained in Chapter 3.

method. Instead, a new formula has been developed which can be expressed as follows:

$$\begin{array}{c} \text{A percent of the first \$X of AMIE} \\ \text{plus} \\ \text{B percent of all AMIE over \$X} \end{array}$$

The numbers represented above by A and B are fixed, but the X would increase as average covered wages increased.

The fixing of the exact amounts of A and X and B, in the above formula, will depend on the precise objectives to be met, as ultimately determined by Congress. They will also depend on the actual date on which the new system is installed. If the system became effective in 1976 and was designed to meet the objectives thus far proposed by the Council, here is an approximation of the formula in numerical terms:

$$\begin{array}{c} 100 \text{ percent of the first \$123 of AMIE} \\ \text{plus} \\ 31 \text{ percent of all AMIE above \$123} \end{array}$$

(The \$123 is adjusted upward each year as average covered wages rise.)

Again it is emphasized that this specific formula is presented here solely to facilitate discussion and not to indicate that it is the only one that can be used, or even that it is the best. For example, there is some opinion to the effect that we need a three factor formula, such as the following:

$$\begin{array}{c} 100 \text{ percent of the first \$X of AMIE} \\ \text{plus} \\ 31 \text{ percent of the next \$Y of AMIE} \\ \text{plus} \\ 20 \text{ percent of all AMIE above \$Y} \end{array}$$

The new system will not freeze benefits in any sense of the word; it will merely stabilize at the various levels the relationship of the benefits to the earnings of the recipient just prior to retirement. Furthermore, the proposed system can be implemented in such a way as not to reduce anyone's benefits as computed under the formula presently applicable to persons now retiring.

Whether the proposed system would produce lower or higher benefits and costs than the present system depends upon the relationship between future movements in wages and prices, factors which no one can predict with certainty. Under the assumptions of the trustees, as to wage and price increases, the long-term benefits and costs of the proposed system will not be as high as under the present plan, but if the movements of wages and prices follow a different pattern, the benefits and costs could be higher under a decoupled system than under the present system. (See Table C on page 51.)

In summary, the new formula will cause benefits to rise solely in keeping with wages during an individual's working years, and after retirement his benefits will increase solely on the basis of increases in

the CPI. The Council strongly recommends that such a decoupled system be adopted. In fact, the Council is convinced that decoupling is by far the most important step to be taken to improve the system.

4.2 OTHER BENEFIT RECOMMENDATIONS

Compulsory Coverage of Government Employees—Some 90 percent of the working population is today covered by social security. By far the largest segment that remains uncovered is composed of government employees, Federal, State, and local. The Council has recommended that social security coverage of these employees be made compulsory in order to prevent the windfall benefits which they frequently receive at the expense of the social security system. (This windfall problem is described in greater detail in Section 1 of Chapter 6 of the Council's report.)

If all government employees were brought under social security, it is estimated that there would be a long-term reduction in the cost of the system of .25 percent of covered wages and a short-term reduction of .70 percent. These are significant amounts, but there are also significant obstacles to such compulsory coverage. A constitutional question clouds the forced coverage of employees of State and local governments. Also, although proposals for coverage of Federal employees have been considered over the years, they have not generally been supported by Federal employee groups and have not been passed by Congress. For these reasons, the Council, while fully in favor of covering all government employees, has decided not to include such potential cost reductions in our later computations of the deficit.

Liberalization of the Retirement Test—Under the retirement test today, a retiree loses one dollar of benefits for each two dollars he earns above the exempt amount, which is \$2,520 in 1975. Such exempt amount rises each year with average covered wages. The Council has recommended that for earnings above the exempt amount, but not in excess of twice the exempt amount, the loss of benefits be limited to one dollar for each three dollars of earnings. For earnings above twice the exempt amount the one-for-two reduction in benefits would again apply.

Equalizing Dependency Requirements—The Council has voted to recommend that the support test for husbands and widowers benefits be eliminated and that benefits be provided for fathers and certain divorced men, so as to provide equal treatment of the sexes.

Liberalization of the Disability Test—The Council has recommended a somewhat less stringent test of disability for workers who are 55 years of age and older.

4.3 OASDI TAX RATES FOR THE SELF-EMPLOYED

The "cost" of an employee's benefits is paid for by both the employee and his employer, with each paying 4.95 percent today, or a total of 9.9 percent. While the self-employed person receives the same benefits as an employee, it was decided long ago to set his tax at 75 percent of the combined tax, which is the same as 150 percent of the employee's tax. This means he should be paying 150 percent of 4.95 percent, or 7.425 percent. In recent years, however, his rate has been

further reduced by being frozen at 7 percent. The Council sees no reason for this deviation, especially in light of the expected increases in future rates for employees and employers. It is recommended, therefore, that the self-employed tax be fixed again at 150 percent of the employee's tax.

4.4 SHIFT OF HOSPITAL INSURANCE CONTRIBUTION RATE TO OASDI ¹⁰

The OASDI program is financed from taxes on covered earnings, because the benefits of the program are always related to the earnings of a worker-taxpayer. This is true even when the beneficiary is a spouse or dependent survivor. The same principle does *not* apply to benefits under part A of the Medicare program. There the amount of the benefits is determined by the hospital and related health care costs of a particular person, and bear no relationship whatsoever to his wages or those of anyone else.

Under such circumstances there does not seem to be any real reason for funding such costs by a tax on wages. Hospital insurance expenditures would seem to be more properly funded from general revenues, and the Council recommends such a proposal to the Congress. ¹¹ If adopted it could make an important contribution to the solution of the financial problems of the OASDI program without an immediate increase in total social security tax rate.

The present social security tax is composed of two parts:

[In percent]			
	Employee pays	Employer pays	Total tax
OASDI.....	4.95	4.95	9.9
Medicare part A.....	.90	.90	1.8
Total.....	5.89	5.85	11.7

If the OASDI tax rate is raised in 1976 by 1.0 percent, as recommended by the Council, and if an equivalent amount of the Medicare part A program is funded from general revenues, the total social security tax would remain the same:

[In percent]		
	Present social security tax	Proposed social security tax
OASDI.....	9.9	10.9
Medicare part A.....	1.8	.8
Total.....	11.7	11.7

For the individual or the employer it means that the OASDI tax would rise from 4.95 percent to 5.45 percent but his hospital insurance (Medicare part A) tax would fall from .9 percent to .4 percent, thereby leaving his overall tax the same.

¹⁰ See statement of Mr. Danstedt.

¹¹ See statement of Mrs. Campbell, Mr. Faulkner, Mr. Scanlon, and Mr. Smith.

There would still remain a Medicare part A tax of .8 percent as a part of the total social security tax. The financing of this .8 percent could be shifted gradually to general revenues as the cost of OASDI rose in future years, thereby making it possible to keep the total social security payroll tax constant for some time in the future.

In actual fact, the hospital insurance portion of the tax is scheduled under *present* law to rise over the next 10 years from 1.8 percent to 3.0 percent, as follows:

[In percent]

	OASDI tax	HI tax	Total tax
1975-77.....	9.9	1.8	11.7
1978-80.....	9.9	2.2	12.1
1981-85.....	9.9	2.7	12.6
1986.....	9.9	3.0	12.9

The schedule above shows that, even without any change in the OASDI tax, the total social security tax would rise in the next 10 years from 11.7 percent to 12.9 percent. This means that if the total hospital insurance burden is gradually shifted to general revenues, the OASDI tax can be raised in the future by an aggregate of 3.0 percent (instead of 1.8 percent) without raising the total social security tax beyond the rate that would have been payable under the present law.

It is obvious that the shifting of the hospital insurance tax to general revenues would create a need for higher income taxes or other levies. Depending on how this need is met, it is quite possible that for many persons the proposal would mean just a shift in the type of tax that is paid. In fact, some persons or employers would incur a higher aggregate tax burden than they would if the OASDI tax were simply increased.

However, to the extent that general revenues are derived from progressive taxes, those in the lower economic groups would almost certainly benefit from the shift of the hospital insurance tax to general revenues. These groups include the persons that would have the greatest difficulty in handling a .5 percent increase in the social security tax. For many of them that tax is already a greater burden than the income tax.

4.5 SUMMARY OF EFFECT OF COUNCIL'S RECOMMENDATIONS

In Table D, below, there is presented a summary of the various items which will make up the assumed deficit as of January 1, 1976 (using the 1974 trustees' report figures as a starting point). This date has been chosen as the earliest possible date on which all of the assumed events can have occurred. The "minus" sign is used in the table to indicate a deficit or an increase in the deficit. The table assumes that:

1. The automatic benefit increase for June 1975, will take place;
2. The Congress will adopt and install a new method of determining benefits that will stabilize replacement ratios;

3. Congress will adopt six changes in benefits which the Council has recommended in various chapters of this report, and which are enumerated below;

4. The self-employed tax is set at 150 percent of the employee's tax;

5. Compulsory coverage of government employees, recommended by the Council, is *not* enacted by Congress. (If this recommendation were to be enacted, there would be a long-range savings of about 0.25 percent of taxable payroll.)

Table D.—Change in actuarial balance of OASDI, expressed as a percent of taxable payroll

	<i>Average Cost</i>
Actuarial Balance from 1974 trustees' report.....	—2.98
Automatic Benefit Increase for June 1975 assumed to be 8.5 percent instead of 4.4 percent.....	— .51
Total.....	—3.49
Changes Recommended by Council:	
1. New method of computing benefits to stabilize replacement ratios ("decoupled" system).....	1.12
2. No benefit percentage over 100 percent and minimum benefit frozen at \$93.80.....	.07
3. Change in retirement test.....	— .02
4. Change in disability test.....	— .13
5. Equalize dependency requirements and benefit categories for men and women.....	— .11
6. Reduce secondary benefits by benefits from noncovered employment.....	.03
7. Reinstating self-employed tax rate at 150 percent of employee's rate.....	.03
Total.....	.99
Revised Actuarial Balance.....	—2.50

SECTION 5. MEETING THE ESTIMATED DEFICIT

As pointed out earlier, the Council has been dealing with the issue of financing during a period when it has been clear that the true deficit is larger than that estimated in the 1974 trustees' report. While the figures for the next trustees' report were not available before this report was prepared, we believe that the basic approach suggested here will be applicable to an increased deficit. The figures here, using the 1974 estimates and assumptions, should therefore be taken as illustrative.

Using the 1974 trustees' figures and the assumptions in 4.5 above, the task is the covering of a long-term, average deficit of 2.50 percent of covered payroll. The 2.50 deficit arises from the difference between the estimated costs of the system and the tax rates in the present law. The recomputed costs, based on the same assumptions as are contained in Table D, and employing the trustees' economic and demographic projections of 1974, are shown below, along with the tax rates in the present law:

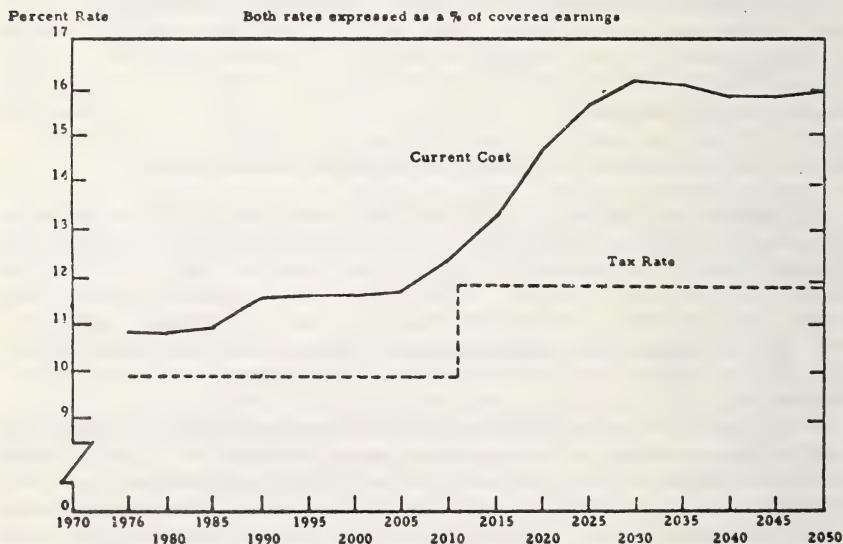
TABLE E

Calendar year:	Cost as a percent of taxable payroll required to meet benefits	Combined tax rate of employer and employee under present law (percent)
1976	10.9	9.9
1985	11.0	9.9
1990	11.6	9.9
1995	11.7	9.9
2000	11.7	9.9
2005	11.8	9.9
2010	12.4	11.9
2015	13.5	11.9
2020	14.8	11.9
2025	15.8	11.9
2030	16.2	11.9
2035	16.1	11.9
2040	15.9	11.9
2045	15.9	11.9
2050	16.0	11.9

¹ Calendar year 2011.

It is quite apparent that there are really two deficits, one long-term and the other short-term. Since each has, to some extent, different causes, they require different solutions. A clearer picture of the problem can be obtained from the following graph.

PROJECTED OASDI CURRENT-COST UNDER ADVISORY COUNCIL RECOMMENDATIONS AND TAX RATES IN PRESENT LAW, 1976-2050



In the graph the deficit is represented by the spread between the cost line and the tax line.

5.1 SHORT-TERM DEFICIT

The short-term deficit (again, based on the 1974 trustees' report and the assumptions in 4.5 above) does require a prompt increase of 1.0 percent in the OASDI tax rate. This means an increase of .5 percent for both the employer and the employee. This increase should not be delayed, because the deficit is already here, not in the future. It arises largely from existing factors, such as the 8.5 percent increase in benefits scheduled for mid-1975. These factors are not delayed in their effect on the system; they cause a prompt increase in the cost and must be offset by higher tax rates. Based on present projections, the rate will also have to rise by an additional .2 percent in 1980 and by a .7 percent more in 1985.

If the 1.0 percent increase in the OASDI tax rate is not enacted by 1976, the OASDI fund will start to go down in absolute terms by several billion dollars per year. It will go down even more in relation to the expenditures for a year, because those expenditures will be rising by several billion dollars per year. This produces a double-barrelled effect on the important ratio of the fund to expenditures. Today the trust fund stands at about \$50 billion, or about $\frac{1}{3}$ of one year's expenditures. If the tax rate is not increased, the fund will fall below $\frac{1}{3}$ of one year's expenditures by early 1978. Even at this level, the system could probably still meet its payment obligations without interruption, but it will certainly cause concern among both workers and beneficiaries. Furthermore, there is no sound reason for letting the fund deteriorate in that way. The deficit exists and should be met now with a reasonable tax increase.

5.2 LONG-TERM DEFICIT

The long-term deficit has its roots in the demographic projection as explained in section 3.3 (pages 48, 49, and 50). Whether that deficit actually occurs will depend on the validity of the estimated future fertility rates and their effect on the composition of the population. It is very difficult to forecast fertility rates with any confidence and the Council recognizes that such forecasts are always subject to error. For that reason the Council's recommended tax rate schedule, below, does not contain any immediate increase in order to handle the long-term portion of the deficit. Such increases are scheduled for later years when the cost increase has been more clearly established.

If all of the various assumptions are borne out, this delaying approach will result in a higher eventual tax rate than we might obtain by an immediate increase now of 2.50 percent. However, the latter procedure would be quite inconsistent with the "current cost" method of financing the OASDI program, because the taxes collected would immediately exceed expenditures by a substantial amount, and a large surplus would be created in the near term.

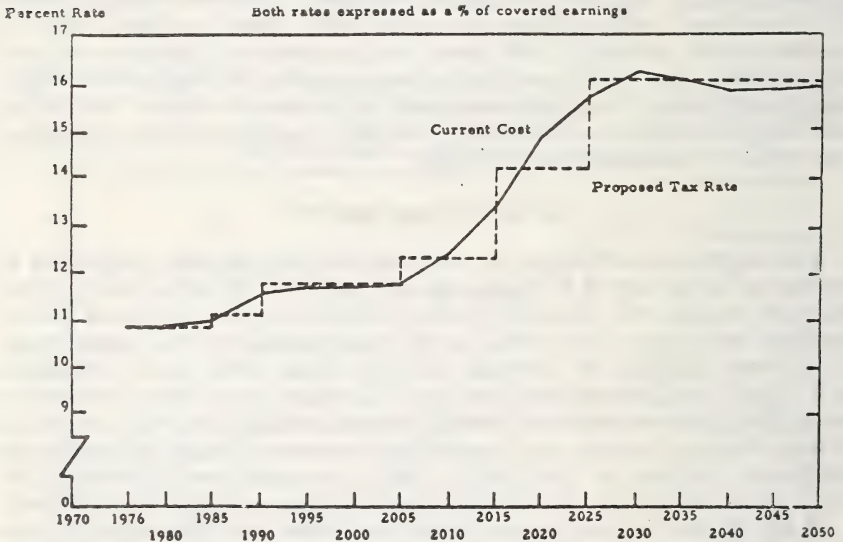
5.3 PROPOSED TAX RATES

Having in mind both the long- and short-term estimated deficits, the Council now proposes a new tax schedule that would handle the problem to the extent that its dimensions are known to us:

	<i>Proposed tax rate expressed as a per- cent of covered Wages [Percent]</i>
1976-1984	10.9
1985-1994	11.1
1995-2004	11.8
2005-2014	12.3
2015-2024	14.2
2025-2050	16.1

These proposed rates approximate the estimated cost curve. By this approach no increase in the tax is provided before it is actually needed, and if future trends differ from the various assumptions herein, the rate can be modified before the fund has risen too high or fallen too low. In the graph below we have presented both the new cost curve and the proposed tax rate structure so that the relation of the two can be clearly seen:

PROJECTED OASDI CURRENT COST AND TAX RATES UNDER THE ADVISORY COUNCIL RECOMMENDATIONS, 1976-2050



It is recognized that an increase of 1.0 percent in the OSADI tax is a significant increase, but the direct impact in terms of social security tax rates can be eliminated through the implementation of the Council's proposal to fund at least part of the hospital insurance program from general revenues.

SECTION 6. OTHER FINANCING PROPOSALS CONSIDERED

In addition to the proposals discussed above, the Council also considered other approaches to the deficit problem. One of these, compulsory coverage of government employees, has already been discussed. Three others are presented below.

6.1 GENERAL REVENUE FINANCING OF OASDI ^{12 13}

One method of dealing with the long-range actuarial deficit in the social security cash benefits program that has been advocated by some, including several members of this Council, is the use of substantial amounts of general revenues. After consideration of this method of financing, a majority of the Council decided against the use of additional general revenue financing in the social security cash benefits program. The Council believes that the deficit can and should be dealt with through the conventional system of ear-marked payroll contributions.

General revenues are used in the present social security cash benefits program only to a very limited extent and only to finance benefits in special cases. General revenues are used in the cash benefits program to finance (a) special payments made on a transitional basis to certain uninsured people age 72 and over, (b) benefits attributable to military service before 1957, and (c) noncontributory wage credits provided for members of the military service after 1956, and (d) noncontributory wage credits for persons of Japanese ancestry interned during World War II. The Council believes that it is entirely appropriate to finance these kinds of benefits from general revenues.

The Council believes that there are compelling reasons against the use of substantial amounts of general revenues in the cash benefits program. Such indirect financing would tend to obscure the true cost of additional benefit liberalizations and could easily lead to pressures for unwarranted increases in benefits. Financing the program entirely from payroll contributions serves to prevent unreasonable demands for increases in benefits. The tie between benefit payments and contributions under the present method of financing fosters a sense of responsibility since the worker knows that higher benefits mean higher contributions. At present when the program must deal with a substantial long-range deficit it is particularly important that any liberalizations be financed in a manner that will not obscure the relationship between benefits and contributions.

Substantial general revenues would also have a detrimental effect on the insurance nature of the program. While there is recognition of the social role of social security through such elements as the weighted benefit formula and provision for dependents, the program is essentially one in which the worker earns the right to benefits through his work in covered employment. The fact that the program is supported almost exclusively from the contributions of covered workers and their employers accords with the insurance aspects of the program. It is this earned-right, contributory principle which is one of the primary reasons for the widespread public acceptance of and confidence in the program.

The introduction of a substantial general revenue contribution in the cash benefits program might lead to strong pressures for the intro-

¹² See statement of Mr. Danstedt and statement of Mr. Arnold, Mr. Cleary, and Mrs. Norwood.

¹³ By Mr. Danstedt. The arguments in this section—that the introduction of the general revenues may lead to a means test and would expose the program to budgetary curtailments—are exactly those which led me and other Council members to object to funding hospital insurance exclusively from the general revenues. Hospital insurance is just as much a social insurance program as OASDI, and as in the case of OASDI, should be substantially financed from payroll contributions.

I believe that payroll contributions for both the cash benefit and hospital insurance programs are essential not only for maintaining the important relationships between benefits and contributions, but to guaranteeing the right to such benefits.

Under a tri-partite approach to financing payroll contributions would be the predominant source of financing and substantially larger than the general revenue contribution.

duction of a needs test for many social security benefits. It would be difficult to justify the use of general revenues derived largely from the progressive income tax to pay benefits to middle- and upper-income workers who are not in financial need.

In addition, the use of large amounts of general revenues would place the social security system in competition with all other government programs for such funds. For budgetary reasons, the Government's contributions might not be paid in the amount or at the time required. There would not necessarily be any guarantee that this money would be available to the social security program when it is needed. In the absence of assurance that these funds would be forthcoming as needed, confidence in the financial integrity of the system would seriously be undermined.

6.2 RAISING THE MAXIMUM COVERED WAGE ¹⁴

Today, only earnings up to \$14,100 per year are covered by social security. Under the automatic changes in the law, this amount will rise each year in the same proportion as average wages rise. This will gradually increase the amount of maximum taxable earnings over the years to come.

There is nothing sacred in the figure, \$14,100; it is largely arbitrary.¹⁵ To help cover the deficit, the Council, at one point, considered raising the maximum covered wage to \$24,000 per year in 1976. It was eventually abandoned because there were formidable arguments against this proposal.

Social security was designed from the beginning as only one of three elements in the income-maintenance system, the other two being: (1) private savings, pension, etc., and (2) public assistance programs. It was logically argued that raising the limit to \$24,000 would cause social security to interfere with the private savings element. It certainly would extend coverage to a level of income where "enforced" savings seems inappropriate, and where it could further reduce needed capital formation.

The only real argument in its favor was that it would hold down the increase in the tax rate which is necessary to cover the long-term deficit. If it were adopted, it would cut the short-term deficit by .89 percent and the long-term deficit by .49 percent.

6.3 INCREASING THE RETIREMENT AGE ¹⁶

After the year 2005, the system will incur substantially higher costs and this will require substantially higher taxes at that time. The high costs and taxes are due to the sharp changes after 2005 in the ratio of workers to beneficiaries, as described earlier herein. If it is desired to minimize those later high costs, the Council recommends that serious consideration be given to gradually extending the retirement age, starting in the year 2005.

The Council is well aware that today most social and economic pressures are directed toward *reducing* the retirement age. Those pres-

¹⁴ See statement of Mr. Danstedt.

¹⁵ The automatic adjustment provisions of the 1972 amendments, however, were intended to keep the wage base ceiling at the same level relative to wages in the future. The \$14,100 base does that. An increase to \$24,000 would break this relationship.

¹⁶ See statement of Mr. Danstedt.

tures arise, however, because the work force is now growing, and there are only 30 beneficiaries for every 100 workers. After 2005, however, the number of people drawing benefits will be growing proportionately faster than the number of people paying taxes, and by the year 2030 there will be 45 beneficiaries for every 100 workers, and the tax burden on the workers will have risen substantially. In such a situation, and given the expected advances in health care and longevity, it seems sensible to at least consider some modest increase in the retirement age so as to maintain a reasonable ratio of workers to beneficiaries and thereby hold down the tax rates.

As an example of how this might be accomplished, every six months the retirement age be increased by one month, beginning in 2005 and ending in 2023. In the latter year, then, the retirement age would have been increased to 68 and the "early" retirement age increased to 65. If this were done, the tax rates would be reduced as follows:

[In percent]

	Tax rate proposed	Tax rate if retirement age raised to 68 by 2023
Calendar years:		
2005 to 2014.....	12.3	12.1
2015 to 2024.....	14.2	13.5
2025 to 2050.....	16.1	14.6

II. REPORT ON MEDICARE PROGRAM

(65)

The Medicare program is the Nation's basic method of providing insurance to help meet the costs of health care for the aged and the severely disabled.

The hospital insurance program (part A of Medicare) helps beneficiaries to meet the costs of inpatient hospital care and related services. It is available to persons age 65 and over who are entitled to monthly social security or railroad retirement benefits, to severely disabled persons under age 65 who are entitled to monthly social security or railroad retirement benefits on the basis of their disability, and to persons under age 65 who suffer from chronic kidney disease.

Benefits under part A are, like social security cash benefits, financed mainly through taxes based on covered earnings. When the program began, provision was made for meeting from general revenues the cost of part A benefits for people age 65 or older who had not had sufficient covered work under the program to become entitled to monthly benefits and who could not be expected to pay hospital insurance taxes. Also, provision has been made (under the 1972 amendments) for aged people who are not eligible for social security cash benefits to enroll voluntarily in part A upon payment of a monthly fee—now \$36, and scheduled to rise to \$40 in July 1975, and to rise thereafter as hospital-care costs rise.

The voluntary supplementary medical insurance program (part B of Medicare) complements the hospital insurance program by insuring enrollees against the costs of physicians' services and certain medical services not covered under the part A program. Part B of Medicare is available to hospital insurance beneficiaries and to virtually all people age 65 and over. This program is financed through the monthly premiums paid by those who enroll in the program and contributions from the Federal Government.

The Council has not recommended any changes in the benefit structure of the Medicare program. Throughout the period during which the Council met, a number of proposals for national health insurance, including the Administration's Comprehensive Health Insurance Program, were under consideration in the Congress and were the subject of widespread public discussion and comment. Most of the major proposals would change in some manner the benefit structure of Medicare. The Council reasoned that any recommendations it might make to change the benefit package provided under the Medicare program might soon be outdated by broader modifications of Medicare within a national health insurance framework. For this reason, and because of the limited time available for its study, the Council decided to concentrate its efforts primarily on the social security cash benefits program.

However, the Council has examined the financial structure of the Medicare program and recommends that the method of financing part A of Medicare be changed. The Council's recommendation calls for a gradual reallocation of the contributions scheduled in the law for part A to the cash benefits program. Eventually, general revenues

would be the sole source of funding for part A. The Council has concluded that the changeover from payroll tax to general revenue financing of part A is warranted because part A benefits are not earnings-related, as are cash benefits. The Council's recommendation on Medicare financing is discussed in Chapter 7.¹

As required by section 706 of the Social Security Act, the Council has reviewed the present financial status of the Federal Hospital Insurance Trust Fund and the Federal Supplementary Medical Insurance Trust Fund, as reflected in the 1974 Reports of the Boards of Trustees. The Council finds the part A program to be actuarially sound.² If the present financing schedule is unchanged it would be adequate to provide for payment of expenditures anticipated over the period for which estimates are made. Of course, it should be noted again that the Council is recommending that the financing schedule be changed by gradually decreasing the payroll tax for part A and replacing the income lost thereby with general revenues.

The part B program is financed on a current basis. In testing the actuarial soundness of the part B program, it is appropriate to look at the period for which the premium rate and the level of general revenue financing have been established. The Council finds that for fiscal years 1975 and 1976, part B premiums, along with anticipated Federal general revenue contributions, are adequate to finance total program costs for those years.

STATEMENT OF STANFORD D. ARNOLD, EDWARD J. CLEARY, AND
ELIZABETH C. NORWOOD

While there is much in this report with which we agree, we feel the need to make a separate statement for two reasons; first, for the purpose of clarification and second, to draw attention to those areas in which the Council failed to make any recommendations.

THE ADEQUACY OF BENEFIT LEVELS

In the "Purpose and Principles" section of this report, it is pointed out that income protection among the aged is made up of three parts; social insurance, private insurance and means-tested programs. Social Security benefits are believed to make up only a part of the income of retired workers. It is assumed that pension incomes or welfare money supplement the retirees' Social Security benefit. This belief in the existence of other sources of income, helps to explain the very low Social Security benefits received by the retired population. Currently, benefits for a single retiree averages about \$2,220 per year (about \$185 per month); the same figure for a retired couple is \$3,720 per year (\$310 per month); and for a widow, \$2,124 per year (\$177 per month).

What is ignored is the fact that for many of the aged, Social Security represents their only source of income. It is generally estimated that about half of all retired persons have no other regular retirement income apart from their monthly Social Security checks.

¹ See statement by Mrs. Campbell, Mr. Faulkner, Mr. Scanlon, and Mr. Smith and statement by Mr. Danstedt.

² By Mr. Smith. I do not believe the Council sufficiently investigated the Medicare program and probable costs thereunder to be justified in making the unequivocal statement that Part A is actuarially sound.

Our concern then, is that it is unrealistic to reaffirm belief in a tripartite system of income protection for the aged, when only one part—Social Security benefits—provides most of the support. Assessments of the adequacy of benefit levels must no longer assume that other outside incomes are making up the difference between a benefit level and what it costs to maintain a decent standard of living.

In keeping its attention riveted on cost factors and the hypothetical tripartite system of income protection, the Council has given inadequate attention to the social adequacy of benefit levels and the need to raise benefits. Until benefits are raised, the true purpose of Social Security—to prevent poverty among the aged—will not be realized.

GENERAL REVENUE FINANCING

We consider the single most important achievement of this Council was its recommendation to move Medicare under general revenue financing. The present Medicare tax paid under Social Security would stay as part of Social Security revenue. This switch of Medicare financing anticipates a national health insurance program and, to some extent, may facilitate this development.

The move to general revenue financing has been debated for many years by past Councils and in the Congress. Economic changes and demands on the system today, however, give this recommendation a new importance. The Social Security trust fund is declining relative to expenditures, and sources of new funds must be found in order to insure stability and confidence in the system. Further, it is no longer acceptable to expect the lowest paid sector to continue to shoulder the expense of the regressive Social Security tax. The move to general revenue shifts the burden towards the better paid.

A remarkable, and in our view regrettable, oversight in this report is the systematic failure to give adequate emphasis to the recommendation to fund Medicare under general revenue which this Council endorsed. We feel this recommendation is the most important one to be made to Congress.

Further, we note in the financing sections of this report, that considerable attention is given to the necessity of increasing the Social Security tax rate. At no time, in our recollection of Council meetings, did this financing alternative receive majority support. In fact, the final Council vote on financing was clearly drawn between the choice for a Social Security tax rate increase and the use of general revenue financing for Medicare. The majority voted against the tax rate increase and for general revenue financing. The sections on financing do not convey this explicit Council decision.

Rather, the opposite impression is given, that is, that the Council supports a Social Security tax rate increase. At no time did we support such a proposal and we emphatically dissociate ourselves from it.

Another funding alternative discussed was increasing the taxable income base upon which the Social Security tax is levied. Though this proposal was not adopted, we supported this change and certainly consider it preferable to any tax rate increases at this time.

FINANCING MEDICARE (PART A) FROM GENERAL REVENUE

In making the recommendation for reducing the Medicare payroll tax, the Council is not recommending any reduction in the intent of

the proposal on Medicare benefits. The intent of the proposal is that sufficient funds be made available from general revenue to continue the Medicare benefits just as if no change in financing occurred.

DISABILITY

Although the Council is recommending a change in the definition of disability as it applies to workers 55 and over, we feel that the change is not comprehensive enough. Simply stated, disability should be strictly related to a worker's last regular occupation. In our view, any alternative definitions which fall short of this, provide insufficient protection to older disabled workers, a group particularly disadvantaged when competing for jobs outside their regular occupation.

INDEXING WAGES (DECOUPLING)

Another important policy recommendation of this Council concerned the issue of "decoupling." Without attempting to paraphrase a description of the subject already covered at some length in this report, we would like to make certain points for clarification. In our opinion, the crucial factor in the argument for the proposed "indexed" system for determining benefit levels, was not the alleged flaws in the present system. The advantages of an indexed system are twofold. First, by stabilizing replacement ratios (i.e., the relationship between a worker's monthly benefit and the monthly wage they earned just before they retired) through a technical formula, Congress might better focus attention on the adequacy of replacement ratio levels. In our view, this is the real merit of the indexing system. A system which predicts benefits according to a set formula, will provide a specific replacement ratio for the working population. Instead of not knowing what a replacement ratio will be, attention could focus on the social adequacy of benefits produced by the formula. When higher benefits are needed, the indexing formula can be adjusted to produce such benefits.

Second, the proposed change has the advantage of updating wages earned many years ago. Wages earned early in a career are reassessed upwards to make them comparable to today's higher salaries. We consider that this change provides more equitable treatment to these wages.

FINAL COMMENT

A controlling factor on this Council's deliberations was the strict time limitation imposed (8 months). The Social Security staff was often called upon to give rough cost estimates on very important financial implications of different courses of action. This led to some confusion and the need to revise "off the cuff" estimates. Council deliberations, based upon partial, misleading or erroneous assumptions, were inevitable. Future Councils simply must be given a more adequate time period for making recommendations of such general social importance.²

We are indebted to Hugh Conway, Consultant to the Council, for assistance in preparing this statement.
² Mrs. Campbell concurs with this comment.

STATEMENT OF JOHN W. BYRNES, RUDOLPH T. DANSTEDT, AND
EDWIN J. FAULKNER

DISSENT TO LIBERALIZATION OF THE RETIREMENT TEST

Much of the dissatisfaction over the Retirement Test stems from a misconception of the nature of the benefits established by the Social Security Act. The old age benefit is not a right to an annuity but rather is "earned income insurance" providing at least partial replacement of formerly earned income lost upon retirement from the work force. The measure of whether the loss indemnified has occurred is the amount of the recipient's earned income, if any, at and after the age of eligibility. Whether Congress should have established an annuity benefit rather than an earned income replacement benefit is beside the point. The Social Security taxes paid have been calculated to finance only the more restricted insurance benefit. Elimination of the Retirement Test for recipients age 72 and older was a political concession to the self-employed who frequently never retire (or more truly think they will never retire), but one that had small financial impact on the system. The annual exempt amount was established and has been increased from time to time to permit benefit recipients to earn some income from employment not conceived as their regular work or of substantial amount, thus somewhat reducing pressures for OASDI benefits.

While the Council's recommendation for liberalization of the Retirement Test is much less onerous and costly than would be the elimination of the Retirement Test, at a time when the system is confronted with long-range financial problems, the additional liabilities involved in liberalization should be avoided. Liberalization of the Retirement Test would intensify the "transfer payments" complexion of OASDI and would encourage retirement at the earliest date of eligibility for Social Security benefits. If it is believed the liberalization of the Retirement Test would be advantageous to only a small minority of recipients since many recipients cannot continue in regular employment because of health reasons, non-availability of jobs, or because they do not want to continue to work. The present Retirement Test provides ample opportunity for those who can and wish to continue to work to earn a reasonable amount without forfeiting all of the OASDI benefits. The exempt amount, under the automatic adjustment provisions of the present law, will be kept up to date with changing levels of earnings in the future. It is estimated the exempt amount will increase to at least \$3,000 by 1977 as a result of this provision. The Act already provides eligible recipients who wish to continue in covered employment with incentives for so doing. A 1% annual increment in benefits for each year of work is provided those who continue to work after age 65. The higher earnings characteristic of employment in recent years permits the older worker to increase his wage history and thus to enjoy a higher average wage on which benefits are computed.

We believe that the Retirement Test as presently constituted should not be liberalized.

STATEMENT OF JOHN W. BYRNES, EDWIN J. FAULKNER, JOHN J. SCANLON, AND J. HENRY SMITH

The Council has recommended that the definition of disability applicable to the payment of monthly benefits to insured workers age 55 or over should be liberalized so as to make eligible those who no longer can engage in substantial gainful activity requiring skills or abilities comparable to those previously engaged in with some regularity over a substantial period. Under such circumstances the benefit payable would be 80% of the primary insurance amount. Thus, the proposal would affect only persons disabled at ages 55 to 61 since those age 62 or over would receive an equal or larger benefit under the early retirement provisions.

A key aspect of the problem to which this proposal is addressed is administrative. The determination of whether disability exists as defined in the law makes for very difficult, contentious case handling. Proper interpretation of the law sometimes seems to have unreasonable results in certain types of cases.

It should be understood, however, that long experience with disability insurance has established unequivocally that all effective definitions of disability—even the more liberal ones—are most difficult to administer. The widely varying physical conditions encountered (often largely subjective) frequently introduce substantial uncertainty. When the physical factors are coupled with employment and skill questions, such as whether the individual can find and do certain kinds of work, the difficulties are greatly magnified. In many cases it becomes impossible to escape uncertainty, disagreement, resentment, legal action and, in the case of governmental administration, charges of hardhearted, bureaucratic inefficiency.

It is our opinion, therefore, that the proposed change, while providing some liberalization, will not overcome the inherent problems of administration. They will still exist under the proposed definition; and having two different definitions to administer adds to the complications. On the other hand, it will increase costs, and to do so at this time does not seem prudent inasmuch as the financing of this part of the program has been deteriorating rapidly. Further, we are concerned that the proposal is of an unstable nature because its age and amount limitations are arbitrary; it is almost certain to be liberalized, significantly increasing the cost of the program further.

In the time available the Council was unable to carry out the extensive investigation of the disability portion of the system which is needed in order to determine corrective measures. As yet, we have no definitive explanation as to why the unfavorable cost experience has developed. We have had no opportunity to examine how the law is applied in individual cases; we did not examine court interpretations. A great deal more study is needed. That being so, it seems unwise to adopt at this time a measure, which would add to the cost burden with no promise of correcting basic deficiencies or significantly easing administrative difficulties.

STATEMENT OF RITA R. CAMPBELL, EDWIN J. FAULKNER, JOHN J. SCANLON, AND J. HENRY SMITH

The Council has recommended that Medicare Part A payroll tax contributions be diverted to meet impending deficits in OASDI

financing and that the government fill in the Medicare loss with funds from the general Treasury revenues.

While this device would meet the early funding problems of OASDI (but not the long range one), it does not seem to us to be an appropriate solution to the problem. It would shift the deficit from one social insurance plan to another, but it would not solve the basic problem of under funding. The Treasury is not an inexhaustible source of funds. The cost would still have to be met and resort to general revenue financing would mark a serious retreat from the principle of payroll tax financing that the Council has endorsed elsewhere in this Report. Also, additional large expenditures from general revenues, unless financed by new taxes, carry the great risk of contributing further to inflation.

The argument that Medicare benefits are not wage related and, therefore, it is appropriate to support them by general revenues, is more a rationalization than a principle. There is no more valid reason now for funding Medicare from general revenues than there was initially. Medicare is now looked upon truly as a social insurance program, and it is just as desirable to support it with joint employer-worker contributions as it is for OASDI. General revenue financing would mask the cost of the program and weaken even further the control over it. Furthermore, it would jeopardize Medicare by placing it in competition with all other government programs financed by general revenues; and it would make it more like a welfare plan which perhaps should involve a means test.

It's our preference, therefore, to approach the problem of the OASDI deficit directly by raising the FICA tax rates in the near future. During the next several years only a limited increase (about a half percent for employees and employer each) would be needed. And certainly, in view of the increasing benefits being provided by the plan, this added contribution is not an unreasonable price to ask. It is likely that in the long run the cost of the OASDI system will rise to levels that will require additional taxation, and we might as well continue to exercise the discipline of balancing benefits and taxes just as we have in the past. In this way the philosophy, integrity and general understanding of the system will be preserved.

SUPPLEMENTARY STATEMENT BY RITA RICARDO CAMPBELL

During the several meetings of this Council, I have felt that we are tinkering at the edges of what was originally, in 1935, a rather simple program, but which has grown because of its many amendments so complex that even the well-informed citizen does not understand it. Additionally, over the 40 years since the initial passage of the Social Security Act, tremendous socio-economic changes have taken place, a whole new welfare system of benefits has been enacted, and other tax laws with which OASDI taxes interrelate have been amended.

Although I view any change in OASDI benefits which adds to present costs as undesirable in view of the short-run and especially the long-run actuarial imbalance, which is based on what I believe to be over-optimistic assumptions,⁴ I have voted as a Council member to recommend some changes in benefits which, relative to the

⁴ See elaboration of this point on page 78 ff.

system as a whole, have minor cost impact. My reason in one instance was to eliminate an inequity which exists because of differences in entitlement between dependents of men workers for secondary benefits and dependents of women workers. My reason in another instance was to improve the social adequacy of the system by making less stringent entitlement to long-term permanent disability benefits for those persons 55 years and over.

The Council's refusal to recommend "fairer" tax treatment of the twenty-two millions of married women who work and many of whom earn little and yet pay OASDI taxes on what are low earnings⁵ is an example of the dangers in "tinkering" rather than restructuring social security into a logical part of the U.S. total system of taxes and social benefits. There are hundreds of thousands of couples, the precise numbers are not known, where both the husband and wife work, earn relatively low wages and pay a tax on those wages and who when they retire at age 65 receive not more but *less* than other couples where the husband has worked and earned the equal of the two-worker family's combined wages and his wife has not worked. For example, as stated in the Report of the Subcommittee on the Treatment of Men and Women, a husband with average, annual earnings of \$4,000 and a wife with average, annual earnings of \$4,000 each receive \$228.50 a month on retirement at age 65, or a monthly total of \$457.00, which is \$17.50 less than \$474.50 or one and one-half the monthly primary benefit payable to a married worker with average, annual earnings of \$8,000 and a spouse who has not worked in covered employment. Further, this situation also exists for comparable families with average annual earnings of \$6,000.

To cite a more general example, consider the difference in benefits upon retirement for two families: Family A, where the wife works and earns 40 percent each year of the family income, the husband 60 percent; and Family B, where the wife does not work. Since the social security program began, the annual earnings of the two families are equal and year-by-year are equal to the maximum, annual earnings tax base which is also used to compute benefits. If it is assumed that all four individuals are 65 during the first six months of 1975, the husband in Family A would receive \$226.50 monthly benefit and the wife, whose earnings were considerably less, \$179.60, for a total monthly retirement benefit of \$406.10. In Family B, where the husband alone has worked, he and his wife would receive a much greater monthly retirement benefit, the husband's primary of \$316.30 plus one-half of this amount ("rounded") or \$158.20, (a secondary benefit) for his "presumed dependent" wife, or \$474.50 in total. For each year that Family B receives retirement benefits, it would receive \$820.80 more (before automatic adjustments to take account of cost-of-living increases) than the two-worker family, Family A.

It is largely because of such anomalies as these which are inherent in the benefit structure that I argue for retirement benefits being paid on an individual basis, as well as OASDI taxes being collected on an individual basis. To argue that working, married women should not only contribute in large measure to the "social" benefits under social insurance, but should also actually in a family unit receive less than

⁵ In 1973, the median earnings of full-time working women were 57 percent of the median earnings of full-time working men. (U.S. Census. CPS. P-60, No. 93, July 1974, p. 2.)

if she had never worked at all and paid substantial taxes is to me ethically unacceptable.

The Council members fail to recognize the impact of the dramatic continuing increase in the numbers of married women who work, generally for low wages, and pay OASDI taxes on those wages, sometimes in preference to going on welfare or anticipating, when they are older, going on welfare. Many of these women pay higher OASDI taxes than income taxes. Many of the twenty-two million married working women (and generally also their husbands) are highly critical of the OASDI program because they know that they will not receive upon retirement or widowhood any more benefits than if they had not worked and paid taxes during their lifetime. They may know that they have protection for dependent children and for long-term disability, but feel that these tax payments are high "premiums" for such insurance. Since the vast majority of these women bear and raise children, they contribute to society in ways beyond what the usual single person does.

In those families where both husband and wife worked in 1973, the *differentials* in annual median income compared to families where only the husband worked, by age of head of household, were as follows:⁶

WORKERS—MEDIAN INCOME

Age, by age of husband	Husband and wife	Husband only	Difference in family income
Whites:			
25 to 34.....	\$14, 186	\$11, 967	\$2, 219
35 to 44.....	17, 056	13, 653	3, 403
45 to 54.....	18, 418	12, 609	5, 809
55 to 64.....	16, 819	11, 918	4, 901
Negroes:			
25 to 34.....	12, 509	8, 528	3, 981
35 to 44.....	13, 082	7, 872	5, 210
45 to 54.....	13, 867	8, 280	5, 587
55 to 64.....	11, 526	5, 853	5, 673

Obviously, married women contribute substantially to the family earnings. The life styles of their families are based on combined earnings, and it is the replacement ratio of combined family earnings, at least of low-paid workers, which the social security system should consider in determining replacement ratios (percentages of earnings replaced by social security benefits upon retirement) if it is claimed to have made some adaptation to the rapid socio-economic changes of the last 40 years.

The argument of the Council's majority that to give more individual equity to working married women is wrong because it would favor a "special group" (Report of the Council, Chapter 5, Sec. 3.1) indicates to me a surprising lack of awareness of today's socio-economic world—a world in which the majority of married women work.⁷

There are other special groups which are smaller in number and for whom the Council has recommended that their benefits be liberalized, e.g., those over age 65 and under 72, who continue to work.

If among married women there is currently a special group, it may be that it is those non-working married women who become entitled

⁶ U.S. Census, P-60, No. 97, January 1975, Table 74, p. 156.

⁷ Mrs. Norwood concurs with the portion of this statement beginning with paragraph 2 on page 74 and ending with this paragraph.

in 1975 and later to only secondary benefits often sizeable and based only on their husband's earnings. These women have not accumulated enough, or any, earnings credits to obtain a primary benefit based on their own earnings and many of them may have husbands who had high earnings from which savings were accumulated and also these women may enjoy other sizeable income as interest, rents and dividends. As the years go by, the number of women who have never worked in covered employment will decline. Of all aged wives of retired worker beneficiaries, the group entitled only to a secondary benefit, that is one-half of their husband's primary retirement benefit because they are "presumed dependent," is estimated by SSA to fall to about 30-35 percent by 2020.⁸ However, by 1970, 68 percent of women, ages 45-49, had already earned enough quarters of covered work to be insured for their own primary benefit. SSA's projection that 30 percent to 35 percent of aged wives of retired worker beneficiaries will be entitled to only secondary benefits by 2020, rather than earlier, as in 1990 or 1995, when the women ages 45-49 would be old enough to be entitled and be drawing benefits, depends on two major assumptions. These are the rate at which women already receiving a secondary benefit leave the rolls by death or other disqualification and the labor force participation rate of women in future years by marital status.

SSA actuaries, in projecting future costs of the system, assumed an increase for women by age groups of their labor force participation rate. For example, the percent of women in the labor force by selected age groups in 1970 (actual) and 1995 (estimated) is:⁹

[In percent]		
Ages	1970 actual	1995
45 to 49	55	59
50 to 54	54	58
55 to 59	49	53

In every case there is an estimated increase.

It is possible, depending on the assumptions used, that women who are entitled only to a secondary benefit—that is they did not work even intermittently and/or part-time to acquire 40 quarters of coverage, the equivalent of 10 years in covered employment—may be 30 percent or even less of all aged women whose husbands are receiving old-age benefits some years before 2020.

For example, an article in the *Social Security Bulletin*¹⁰ states that, "More than half the women between ages 60 and 64 in 1970 were insured for benefits in their own right. Among women in their forties and early fifties in 1970, 2 in 3 were earning insured status at a rate that would qualify them for benefits when they reached retirement age."

My proposal is two-fold. The first part was supported by the Subcommittee on the Treatment of Men and Women (see Report, Ap-

⁸ Office of the Actuary, SSA.

⁹ Developed by the Office of the Actuary, SSA, for use in long-range cost estimates in the 1974 Trustees' Report, unpublished data.

¹⁰ V. Reno, "Women Newly Entitled to Retired-Worker Benefits . . .," *Social Security Bulletin*, April 1973, p. 4.

pendix B, pp. 147-148), but the second part was not. The proposal is (1) to help low-earning, married men and low-earning, married women by permitting a couple coming on the benefit rolls in the future an option in computing their retirement benefits to combine their earnings up to the taxable base (thus helping only low earners) when each of them has paid taxes on 10 years (40 quarters) of covered earnings during the last 20 years prior to retirement at a long-run cost of 0.20 percent of taxable payroll; and (2) to phase out gradually over a 30-year period (see Subcommittee Report, p. 146 details) secondary, retirement benefits of an aged spouse (wife or husband). The secondary benefits of surviving spouses and children would be retained. The second part of the proposal would result in an estimated long-run savings of 0.39 percent of taxable payroll. This estimate assumes that the following three recommendations initially made by the Council will be enacted and effective immediately.¹¹

(1) The same rules of entitlement to secondary benefits would apply to men and women; (2) immediate universal coverage and (3) for those coming on the rolls in the future an immediate offset of a private pension earned in uncovered employment against secondary, retirement and survivor benefits of social security based on earnings of a spouse in covered employment. If either of the latter two recommendations are not enacted and the first one is enacted—as is likely to be the case, as note the finalized version of Chapter 7 of the Council's report points out that universal coverage will face many obstacles—then the savings would be somewhat greater than 0.39 percent of payroll. Actuarial data are not available covering the cases when all or some of these assumptions are dropped.

There are among the 8.8 million workers who are not currently covered, 3.6 million persons who work for State and local government, where legal problems probably would interfere with their rapid, compulsory coverage under social security.

The Council voted to recommend, without any phase-out period but merely prospectively, to treat as an offset against both the retirement and survivor's secondary benefits, based on the spouse's covered earnings, any pension earned by the other member of the couple which derives from work in non-covered employment. This recommendation would create a new inequity primarily to a particular class of married, working women and that is those wives whose husbands work in covered employment while they work in non-covered employment as in civil service or in many States as school teachers. The lack of a phase-out period gives virtually no time for these couples, some of whom may be within ten or less years before retirement, to attempt to make up or recapture the proposed sudden loss in secondary benefits to the wife and benefits on which their retirement plans have been based.¹² This is an example of what "tinkering" with benefits, rather than restructuring the system to pay retirement benefits on an individual basis, may do.

The second part of my proposal has a phase-out period of thirty years to avoid a comparable inequity to non-working, married women and it applies only to retired couples not to the surviving spouse.

¹¹ Office of the Actuary, SSA.

¹² Mrs. Norwood also concurs with the portion of this statement beginning with paragraph 3 on page 77 and ending with this sentence.

Under my proposal the secondary benefits to aged wives and/or husbands without a dependent child in their care would be phased out at the end of 30 years. Thus, the largest savings impact would occur at a most favorable time to coincide with the timing, the year 2005, when the double impact of high costs of total benefits due to the relatively large number of World War II babies who will be retiring and collecting OASDI benefits, and concomitantly of fewer workers to pay these benefits as the relatively fewer births during the past several years enter the labor force, occurs.

The Finance Subcommittee and the Council's Reports reflect the estimate used in the 1974 Report of the Boards of Trustees that the fertility rate will return to 2.1 babies per woman, the population replacement rate, by 1985. It is anticipated that the double impact of more beneficiaries and relatively fewer workers will increase the number of social security beneficiaries from 30 beneficiaries for every 100 workers to 45 beneficiaries for every 100 workers by the year 2025. In 1950 the ratio was 6 beneficiaries for every 100 workers.¹³ If a fertility rate of 2.1 is not achieved by 1985, and there are good reasons to anticipate this, then the long-run actuarial imbalance will be considerably greater.

Because only a single set of assumptions, covering projected birth rates and price and wage increases, were presented by the Finance Subcommittee to the Council (and these are the same as in the 1974 Trustee's Report) rather than is more customary, a range of low, medium and high estimates, and the single set of assumptions was accepted by the Council as "reasonable," the underlying assumptions of the long-run projected deficit should be examined critically.

The three assumptions are: (1) an annual 5-percent increase in average money wages, (2) an annual 3-percent average increase in the Consumer Price Index and thus a 2-percent average rate of increase in real wages and (3) a 2.1 fertility rate by 1985, which will remain constant at that level for the remainder of the 75 years.

If, however, 1.9 births per woman were the average fertility rate for the whole 75 years, the 2.98 percent actuarial imbalance would be 3.73 percent of taxable payroll. Additionally, without decoupling the system but with a steady annual rate of growth in real wages of only 1 percent, based on wages increasing at 5 percent and prices increasing at 4 percent, the long-run deficit may be as high as about 10 percent of taxable payroll.¹⁴

It is noted in the Finance Subcommittee Report of February 3, p. 98, and also in Chapter 7 of the Council Report (Sec. 3.3), that ". . . the demographic projection has an almost overwhelming effect on the costs of the system. . . . The change [by the Trustees of the funds in their 1974 Report] in population assumptions accounts for 63 percent of the total deficit and 76 percent of the increase in the deficit since the last actuarial review." (p. 98, "Deficit" is the long-run actuarial imbalance.)

The argument to support an assumption of 1.9 births rather than 2.1 births per female over the 75 years period follows. Because of the change in technology in respect to birth control, it is the woman, and

¹³ Subcommittee on Finance Report, February 3, 1975, p. 98.

¹⁴ Office of the Actuary, SSA.

not the man, who decides for the first time in history the number of children a woman will bear. Because of this factor, it is impossible to predict on the basis of experience, future birth rates, and the statistical data available appear to support this conclusion.

I attach as Exhibit A, a graph which gives birth rates by age of mother, 1945-1973, originally drawn on a "semi-log" scale,¹⁵ but redrawn here on the normal scale to which most persons are accustomed and which does not compress the extreme drop, but rather makes clear the size of the drop from 1960 on in birth rates by age of mother. There is clearly a precipitous decline in birth rates for each of the five-year age brackets which the compression of the original chart tends to minimize.

Additionally, the February 1975, Census Bureau's *Population Estimates and Projections*¹⁶ includes a range of estimated birth rates through the year 2025, one of which, Ser. III, is only 1.7 births per woman, in order "to provide a reasonable range in projections of future births." (p. 3).

My proposal supports the philosophy of a replacement ratio of earnings lost by retirement, but interpreted as replacement ratio of family earnings. Two-worker families gear their style of living to two incomes. The replacement of "head of household" earnings with an allowance for his dependents does not fit the facts of family structure in 1975. Married couples with only the husband working no longer comprise the majority of families in those age brackets where it is usual to work.

The advantages of the two proposals as a package would be to give greater equity to married women who work and eventually, as the phaseout is completed, greater equity to singles who work, pay the same tax and have no dependents. It is my belief that because of the continuing trends in the increasing labor force participation rate of women, the declining labor force participation rate of men, the increase in divorce and decrease in marriages, and the decline in the birth rate, it is advisable to begin now to restructure the social security system to adapt to these socio-economic changes rather than wait for dissatisfaction with the system to so increase as to force hurriedly changes which may be undesirable.

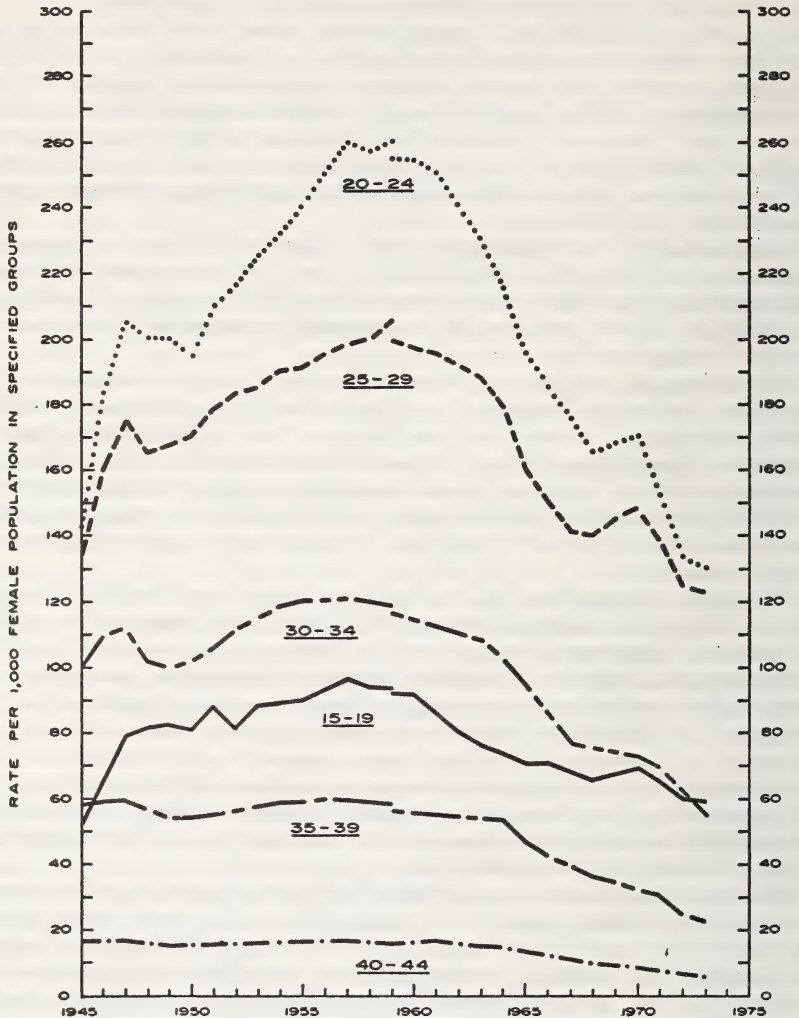
The current system, coupled with Federal income taxes, discourages women from working outside of the home and also discourages private savings which provide the financing for investment needed for growth of national real income. As the ratio of beneficiaries to workers increases, it will create a need for more revenues to finance social security benefits, but from taxes on relatively fewer workers or producers. Then the undesirable effect of the loss of economic product to society because of penalties imposed by the tax system, and especially by OASDI taxes on married women, will become more obvious. It may be in the area of inducing a higher labor force participation rate by women, rather than in attempting to extend normal retirement age to 68 years, that long-run solutions may be successfully sought.

¹⁵ *Monthly Vital Statistics Report*, Vol. 23, No. 11, Supplement, Jan. 30, 1975, p. 3.

¹⁶ Ser. P-25, No. 541.

EXHIBIT A

BIRTH RATES BY AGE OF MOTHER: UNITED STATES, 1945-73



(BEGINNING 1959 TREND LINES ARE BASED ON REGISTERED LIVE BIRTHS; TREND LINES FOR 1945-59 ARE BASED ON LIVE BIRTHS ADJUSTED FOR UNDERREGISTRATION.)

STATEMENT OF RUDOLPH T. DANSTEDT

The Council has made three major findings and recommendations and several minor ones:

1. I strongly support the statement on the philosophy and objectives of social security in which the Council unanimously endorsed the major principles of the contributory, wage-related social security program.

2. I support the Council's recommendation that the method of computing social security benefits be changed to a system guaranteeing that the protection for current workers is kept up to date automatically at least as high as future increases in the level of earnings and that, as in the present system, benefits once payable would be kept up to date with increases in prices. I support this recommendation, however, with the understanding that the "wage replacement ratios" established under the new system will be those pertaining under present law after the updating of benefits in June of 1975.

3. I strongly disagree with the Council's recommendation that the hospitalization insurance part of Medicare be changed from a program of contributory social insurance to one which would be entirely supported by general revenues and that the contributions now earmarked for hospital insurance be shifted to the support of the cash benefit program.

The Council made several other recommendations which, however, compared with the above recommendations are of lesser significance.

While agreeing that the definition of disability for older workers (55-64) should be liberalized, the Council's liberalization of the disability definition does not address itself adequately to the older disabled worker in a job market that discriminates against the older worker. I support a definition under which older workers should be able to qualify for disability benefits if they are occupationally disabled, that is, if they can no longer engage in substantial gainful activity in their last regular occupation. These older occupationally disabled people are in a situation similar to that in which many people find themselves at age 65 when, because of their age, they cannot find job opportunities, and are in effect superannuated.

I disagree with further loosening up of the retirement test. Basically I strongly support the concept of social security as retirement insurance. The present retirement test with its automatic adjustment for an increase as wages rise is a liberal one. It allows individuals to have more in total income—social security benefits plus earnings—the more an individual works and earns. Under present law some people earning as much as \$8,000 or \$9,000 a year may still be eligible for partial social security benefits.

I see no good reason to incur extra costs for the program to favor further those who are fortunate enough to be able to continue at work, particularly the self-employed and professional people and higher-paid salary and wage workers who frequently do not encounter the same age barriers to gainful activity as other members of the labor force.

ABOLISHING MEDICARE AS AN EARNED RIGHT

I want to indicate in detail why we strongly disagree with the Council's recommendation to change the hospitalization part of Medicare from a program of contributory social insurance to one which would be entirely supported by general revenues, and shift the contribution now earmarked for hospital insurance to the support of the cash benefit program.

The charge to the Council from the Congress specified an examination of "The scope of coverage and adequacy of benefits and other

aspects of the Program" including Title XVIII—Medicare. However, at an early stage of the Council's deliberations, the lateness of the Council's appointment which allowed only nine months for its study, and the extensive study presumably underway of national health insurance proposals, were presented as reasons for this Council excluding an examination of Medicare.

I agreed reluctantly with this decision because I believed that the Medicare program for older and disabled people should be improved in several important respects. I was and am now concerned with the financial burden on low and middle-income social security recipients of the \$6.70 per month premium payment of Part B of Medicare which reduces their cash benefits approximately 5%. I support for financing purposes elimination of this premium by combining Part A (Hospital Insurance) and Part B (Supplementary Medical Insurance)—now financed through premiums and general revenues—of Medicare and the financing of Medicare by one-third contribution from employees, one-third contribution from employers and one-third from the general revenues. Such a recommendation was endorsed by the 1970–1971 Advisory Council.

In spite of the fact that the Council has not studied the Medicare program, at its very last meeting the Council voted to fundamentally change the nature of the hospital insurance part of Medicare from a contributory social insurance system to a system which would be one entirely supported by general revenues. In contrast to the careful work of the Council and its staff on the cash benefit part of social security, the reasoning put forth in support of this recommendation shows a lack of serious attention and analysis. The notion that hospital insurance should be paid for entirely by general revenues because the medical benefits provided by the hospital insurance program vary according to the medical needs of the insured individual seems to be based on a misunderstanding of the nature of health insurance. What people are paying for under the Medicare program is "protection against a risk." The fact that some people may draw much more in the way of benefits than others is no more a reason to drop the contributory concept than it would be to drop the contributory concept in the case of the life insurance part of the program where the amount actually paid differs according to the age of the individual at death, the number of dependents, etc.

Moreover, the fact that the amount of protection under hospital insurance (as distinct from the value of benefits actually paid) does not vary by past earnings does not seem to us a significant reason for dropping the contributory principle. In hospital insurance it is the fact that those who earn more pay somewhat more for the same protection and the fact that more of the employer's contribution is used for the protection of the lower paid that introduces progressive principles into the program. In the cash benefit program this result is accomplished by the combination of a flat percentage contribution rate but a weighted benefit formula. In the Medicare program the progressive element is established by having the low-wage earner pay less for comparable protection.

I am greatly concerned that changing Medicare from a contributory social insurance program to one supported entirely by general revenues could well lead to the loss of the concept of earned right and to the possible introduction of an income or means test into the program.

Workers contribute toward hospital insurance with the clear understanding—amounting to a social compact with their government—that when retired or disabled with income down and the incidence of illness up—their hospital insurance costs will be paid as a matter of right.

It needs to be underlined that when Medicare was enacted the representatives of large groups of organized employees—the AFL-CIO and a wide range of international unions—supported the payroll contributions for hospital insurance as a guarantee that hospital insurance shall be an earned right. This continues to be their position.

If Medicare is to be supported entirely by the general taxpayer rather than in significant part by earmarked contributions from those who are to benefit from the protection, the question in the future will inevitably arise as to why general funds should go to pay for the hospitalization and physicians' bills of a selected group in the population—the elderly and disabled—regardless of whether or not a particular elderly or disabled person is entirely able to pay for the services on his own. Thus I fear that the recommendations of the majority could over time transform the Medicare social insurance program into a relief program. There is enough experience with the income-tested Medicaid program to predict what the implications of such a transformation would be for the perpetuation of a two-class system of medicine and in terms of undermining the dignity of the recipient.

If the protection that is now afforded the hospital insurance program by its contributory nature is destroyed, it is likely that it would become much easier to reduce the protection provided. In times of budgetary restriction it would be easier to propose and harder to restrict such money-saving proposals. Even today, this Administration is seeking to reduce the deficits in the unified budget by requiring the elderly and disabled to bear more of the cost of Medicare through cost-sharing. Thus I fear that the proposal to finance Medicare out of general revenues so as to use the hospital insurance contributions for the cash benefit program could easily result over time in the elderly being asked, in effect, to make up for the deficits in the cash benefits program through reduction in their health insurance protection.

Although the Council had not considered these matters or any other matters concerning the Medicare program and operating under the pressure to conclude its affairs on its final meeting day, the Council seized on the hospital insurance contributions to finance the deficit in the OASDI program.

RECOMMENDATIONS FOR IMPROVING THE FINANCING BASE FOR THE CASH BENEFIT PROGRAM

Instead of sacrificing the Medicare program in order to improve the financing base for the cash benefit, I propose that the financing problems of the cash benefit program be faced directly.

That the outgo of the cash benefit programs should exceed income in the immediate future is not a cause for concern. The \$46 billion in trust fund assets available to the OASDI program exist for just this purpose. The reserves should be drawn on in a period of recession like the present. What this means is that social security beneficiaries

get more money to spend than is being deducted from worker's earnings as social security contributions, and today that is good for the economy.

The annual deficit, however, cannot be allowed to continue. To meet this deficit I propose first, that beginning in calendar year 1977 the maximum amount counted for the computation of benefits and for contributions—the wage base—should be raised above the approximately \$16,800 that can be expected to be in effect in 1977 under present law. The economic impact of such an increase would not be felt until the fall of 1977 because it is not until then that any significant number of workers would have earnings that exceed the \$16,800 figure that would be in effect in any event. The exact amount of the increase in the earnings base should be determined by whether it is to be done in one step or in several steps. One alternative is to increase the amount to \$24,000 in 1977 and have it rise automatically from this figure as wages increase. Another possibility is to provide for more gradual increases, that is, a lesser increase for 1977, compensated for by larger increases later. It is of interest to note that the AFL-CIO Executive Council has endorsed moving the wage base up to \$28,000 over a period of years.¹⁷

I propose, further, a tax on the employer's full payroll. A maximum on the benefit and contribution base for individual workers is appropriate since the amount that people pay and the amount that is credited to their record for benefit purposes should be tied together, and it would seem unreasonable under social insurance to compute benefits on the very high salaries earned by the top 2 percent or 3 percent of the wage-earning portion of the population. There is no similar need for a limitation on employer's payroll. The tax on employer's payroll is less now than contemplated in the original Social Security Act. There was then provided an ultimate combined employer tax rate for social security and unemployment compensation totalling 6 percent. Because of the lower proportion of wages now covered under the experience rating of unemployment compensation and the increased tax deductible advantages now available through corporate tax laws, the tax burden on employers is now significantly less than provided by the original law.

With a higher benefit and contribution base, the contribution schedule in present law would substantially over-finance the Medicare hospital insurance program for many years into the future. Consequently, it would be possible to allocate the 1978 scheduled increase of 0.2 percent of payroll to employees, and a like amount on employers, to the cash benefit program rather than to the hospital program. I propose that this be done.

The increase in the wage base I am proposing would return the system, partly, but not all the way, to the original program intent. In 1938, the first year for which there is adequate social security data (the social security system began to collect contributions in 1937), 97 percent of all the workers in the system had their full wages counted toward social security. Today, only 85 percent of the workers covered by the system have all of their earnings counted. To get back to the situation that existed at the time the program first went into effect

¹⁷ Mrs. Norwood concurs with this paragraph.

would require an earnings base substantially in excess of what I propose, probably an earnings base in 1977 in excess of \$30,000.

Although the Council adopted an increase in the tax base to \$24,000 at its next to last meeting, because of a concern that an increase in the maximum earnings base would invade an area of protection which it was argued should be left to private pensions and individual savings, the Council at its last meeting rescinded this earlier decision. It was my view then and is now that an increase in the earnings base such as I have proposed would still leave substantial room for supplementation by private pension plans and savings. The replacement rate for the worker earning at the \$24,000 maximum would be only about 35 percent.

Moreover, such a higher wage base obviates the necessity for an increase in the contribution rate—a position which I strongly favor—and imposes no additional cost on the middle level and lower paid workers, while providing increased protection for those who pay more. It is important to emphasize that the social security program provides a unique protection which offers the workers absolute assurance as to vesting, portability and receipt of benefits when they are due. Raising the maximum earnings base increases benefit protection for workers as well as contributes to the improved financing of the program. For example, if the maximum earnings base were increased to \$24,000, a 55 year old worker earning the maximum amount would get nearly \$125 a month more when he retired at 65 than he would if the earnings base were left as in present law. If he were 60 when the increased earnings base went into effect, he would get benefits at 65 of somewhat more than \$50 a month above present law.

I share the Council's commitment to income programs supplementary to social security, effective private pensions (as well as individual insurance, savings and other investments) but I hold that we must also keep in mind that less than one-third of all older people now have supplementation from private pensions and even in the long run it is doubtful whether the proportion would exceed 50 percent. Maintaining the financial integrity and protection of the social security system is thus of paramount concern.

These steps that I propose—the increase in the maximum earnings base, a tax on the employer's total payroll and the reallocation of the 1978 contribution increase from hospital insurance to the cash benefit program—would solve what the Council has described as the short-run financing problem of the cash benefit program and carry the cash benefit program on a self-sufficient basis well into the late 1980's.

However, depending on what happens to wage and cost of living rates, a limited contribution may be required from the general revenues in the last decade of this century.

I propose, therefore, to meet this possible contingency by restoring to the Social Security law the provision for general revenue financing that existed from 1944–1950 as follows: "There is also authorized to be appropriated to the Trust Fund such additional sums as may be required to finance the benefits and payments provided for in this title."

The financing problem in the next century growing out of the likelihood of an increasing proportion of older people as compared to those of working age, will require a gradual introduction of a government contribution.

As I have indicated, I am opposed to solving the financial problems in social security through an increase in the contribution rates beyond those provided in present law. In place of further contribution rate increases beyond those presently scheduled, I believe that the government, as in other countries, should make a contribution to the social security program, not just for the hospital insurance part of Medicare but for the cash benefit program as well. Thus, in the long run, I see a social security system covering both cash benefits and health insurance financed partly by employer contributions, partly by employee contributions, and partly by contributions from the government in recognition of society's stake in a well-functioning social insurance program. While preserving the values inherent in contributory social insurance, such a tri-partite approach will make the financing of the system more progressive.

To recapitulate—I seek to deal responsibly with the OASDI deficit in the proposals we have presented, introducing at a later time the use of the general revenues when this is indicated. The Council's proposal does not only undermine the Medicare program, but adds \$7-8 billion now to the government's deficit when this deficit is at an all time high. I believe this proposal is the more fiscally responsible one.

SOCIAL SECURITY IN THE 21ST CENTURY

Whether or not there are financing problems for social security in the next century depends, under present law, not only on the future course of fertility rates but on what happens to wage and price increases over the next 75 years. I do not believe it is wise to place substantial reliance on any particular set of assumptions concerning the movement of wages and prices. The assumptions made in the 1974 Report of the Board of Trustees of an average increase of 5 percent in wages and an average increase of 3 percent in consumers' prices produces one level of deficit in the funds after the year 2000. An assumption of a 5 percent increase in wages and a 2 percent increase in the cost of living, on the other hand, would eliminate the deficit even with the fertility assumptions used in the Trustees' Report. Higher assumptions, such as an average increase of 6 percent in wages and 4 percent for the cost of living, as assumed in a recent study by a group of consultants to the Senate Finance Committee, produces still larger deficits than those shown in the 1974 Trustees' Report. Under these assumptions, retirement benefits at award would have increased under present law by the year 2045 by 56 percent more than the increase in earnings. It also produces unreasonably high increases in wage replacement rates. In my judgment, such benefit results would never be allowed to take place and would call for legislative correction. Consequently, I consider the cost results of such assumptions to be highly unrealistic.

Fortunately, the Council's recommendations for basing benefit computation on a system of wage indexing largely removes these uncertainties, making the level of protection more certain and the cost-estimating job more reliable. Pending this change in the benefit system, a change which I support, I see no need to provide, on the

basis of a highly speculative set of assumptions concerning the movement of wages and prices, a set of contribution rates in the next century that are any higher than those required to support the program over the next few decades, and have recommended that it would be more reasonable now to provide specifically for contribution income to finance the present program over such a period, and at the same time to restore to the social security law the provision for general revenue financing that was contained in the law from 1944 to 1950.

The predicted change in the age composition of the population does not present any major increase in the burden of supporting non-workers. The very assumptions that lead to an increasing proportion of older people to those of working age leads to a smaller number of children per person of working age. Taking the two non-working parts of the population together—the retired aged and children—there is little change in the ratio of dependents to workers. Thus the resources now required for the upbringing and education of children can under these population assumptions be directed toward providing for older people, at least in part, without any increased burden on current workers. Under such circumstances there is little doubt also but that labor force participation of older people would increase. Cost savings to social security would, of course, result from such increased labor force participation by older people. It is not necessary to change the legal age at which an individual becomes eligible for benefits, as discussed in the Council. With greater opportunity for employment, the cost savings will come about automatically. The proposal to change the legal age of entitlement not only violates the agreement between the social security payee and his government, but penalizes the person who chooses to retire or has to retire because of health or employment circumstances.

It is also possible that costs in the next century measured as a percentage of covered payroll will be smaller than indicated by current estimates because of greater labor force participation by women. With smaller families such a result would seem to be quite likely. Most fundamental, of course, is the long-range trend of productivity increases. Although as indicated earlier, the long-range actuarial deficit of the system is 3% of payroll with an assumption of 5% increases in wages and 3% increases in prices and a 6% of payroll deficit on a long-range assumption of a 6% increase in wages and a 4% increase in prices, an assumption of a 5% increase in wages and a 2% increase in prices shows the present program to be fully financed! Thus, whether or not there really is a long-range financing problem for social security depends on a highly speculative set of assumptions about fertility rates, labor force participation rates, and long-range movement of wages and prices and the productivity of the labor force.

CONCLUSION

I share the firm conviction contained in the title of the recently issued White Paper, endorsed by *five* former HEW Secretaries and three former Social Security Commissioners, "Social Security: A Sound and Durable Institution of Great Value," that (1) the short-term financial problems of the system are clearly manageable without radical change, and (2) that any long-range problems in financing can and will be met in a way to fully redeem the promises made to social security contributors."

APPENDIX A ¹REPORT OF SUBCOMMITTEE ON FINANCE OF THE 1974 ADVISORY
COUNCIL ON SOCIAL SECURITY, FEBRUARY 3, 1975

The Subcommittee on Finance was charged with the basic responsibility of reviewing the financial condition of the system and recommending changes that would improve it. As a collateral task, it also reviewed all of the proposals made to the Council which might have a financial impact on the system.

In its work, the Subcommittee received advice and assistance from five independent professionals, consisting of three actuaries and two economists,² and they are referred to in this report as the "Consultants." Certain staff members of the Social Security Administration were also very helpful, providing a wide variety of technical data and numerous projections and analyses.

The Social Security system consists of two programs:

1. Old-Age, Survivors, and Disability Insurance, known as "OASDI";

2. Hospital and Medical Insurance, known as "Medicare."

The short time allowed for the Council to complete its work was far too limited to permit the Subcommittee to review all aspects of both programs. In this report, therefore, we have concentrated our attention very heavily on OASDI because it has certain long-term financial problems of a complicated nature. Only in the late pages of the report do we discuss briefly a change in the method of financing the Medicare program which has been proposed by the Council and which could affect the OASDI tax.

¹ See statement of Mrs. Norwood.

² Phillip D. Cagan, National Bureau of Economic Research; Martin Feldstein, Department of Economics, Harvard University; Robert J. Myers, Professor of Actuarial Science; Temple University; Charles L. Trowbridge, Senior Vice President and Chief Actuary, Bankers Life Company; Howard Young, Consulting Actuary and presently Special Consultant to the President of the United Auto Workers.

CONTENTS

	Page
Introduction:	
I. Basic characteristics of OASDI system.....	93
A. General characteristics.....	93
B. Automatic changes in benefits.....	95
II. Trustees' report of 1974.....	95
A. Major assumptions and resulting deficit.....	96
B. Shape of deficit and cause.....	97
III. Testing trustees' conclusions.....	99
A. Economic assumptions.....	99
B. Fertility rates.....	101
C. Summary of analysis.....	102
IV. Size of OASDI trust fund.....	102
V. Deficit increase due to benefit increase for June, 1975.....	103
VI. Corrective proposals.....	103
A. Revised benefit formula to stabilize replacement ratios.....	103
1. Present system.....	104
2. Instability of replacement ratios.....	105
3. Proposed new system.....	106
a. Indexed earnings.....	107
b. New benefit formula.....	107
B. Changes in benefits.....	108
1. No benefit rate to exceed 100 percent.....	109
2. Freezing the minimum benefit.....	109
3. Liberalization of the retirement test.....	109
4. Liberalization of the disability test.....	109
5. Equalizing dependency requirement.....	109
6. Eliminating certain double benefits.....	110
C. Tax on the self-employed.....	110
D. Compulsory coverage of Government employees.....	110
E. Financing medicare from general revenues.....	111
VII. Financing the OASDI deficit.....	111
A. Recomputation of the deficit.....	111
B. Long term deficit.....	113
C. Short term deficit.....	114
D. Proposed OASDI tax rates, 1976-2050.....	114
E. Total Social Security tax rates.....	115
VIII. Other considerations.....	117
A. Raising the maximum covered wage.....	117
B. Increasing the retirement age after 2050.....	117
Conclusion.....	118
Statement of Mrs. Norwood.....	122
Supplement to Appendix A. Report of actuaries and economists.....	124
Addendum of report of actuaries and economists: Decoupling of OASDI system.....	128

I. BASIC CHARACTERISTICS OF OASDI SYSTEM

A. GENERAL CHARACTERISTICS

As an essential prelude to our analysis, we have set out below some of the system's basic characteristics.

Discussions of OASDI usually focus on retirement benefits, and most of the examples in this report are drawn from that aspect of the system. It must always be remembered, however, that there are also very significant benefits available to those who become disabled and to certain dependents of both disabled and deceased workers.

The OASDI system employs the "current cost" method of financing. Under this type of plan, no fund is created during the life of a worker from which his benefits are ultimately paid. Instead, virtually all of the Social Security taxes he pays are immediately paid out by the government to persons who are already beneficiaries. When he, himself, retires, his benefits will be paid from the taxes collected at that future time from the persons who are then working. The tax rate is therefore set so as to provide tax receipts that approximate current expenditures.

While such a system would be questionable for a private pension plan, it is perfectly sound for OASDI, because the government has the continuing power to tax future workers in order to pay benefits in the future to those who are now working. In essence, the plan transfers money from one generation to another, with the amount taken from one generation being measured by the other generation's benefit requirements.

A system of this kind can have a definite impact on the nation's rate of saving and capital formation. Oversimplifying for purposes of illustration, it can be said that, if there were no OASDI, individual earners would presumably save some or all of the money they now pay in Social Security taxes in order to have something for their retirement. These savings would be invested in stocks, bonds, savings accounts, and other forms. Under OASDI, however, the taxes paid by workers are transferred to persons who are primarily consumers, not savers, and capital formation will usually be thereby reduced. Since the tax revenues of the system now approximate \$65 billion per year, the effect can be material. No one would argue from this that the system should be abolished, but the phenomenon must be understood and needs to be considered when increases in benefits and taxes are contemplated. The Subcommittee did not have nearly enough time to properly investigate such a complex subject. Because of the widespread concern over the sufficiency of capital formation in this country, the Subcommittee urges that Congress authorize a definitive study of this important aspect of Social Security.³

³ Some authorities have recommended that the system be substantially funded, arguing that the much larger payments of taxes that would result would eventually work their way through our economic system and provide needed additional capital to private users. Martin Feldstein, of the Harvard Economics Department, is such a proponent.

In the present system, there are constant changes in the number of workers, beneficiaries, wage and benefit levels and other factors. This makes it very difficult to express the cost of the system in absolute dollars in any meaningful way. The cost can best be expressed as a percentage of total "covered earnings," meaning earnings subject to the OASDI tax. This is the measure of cost that will be used herein because it focuses attention on the size of the burden to be borne by each individual taxpayer and employer. As an example, the cost of the OASDI system in 1974 is estimated to be 10.67 percent of covered earnings. With a maximum covered wage of \$13,200 per person, the total covered earnings in 1974 were approximately \$600 billion, so the absolute cost of the system in that year was about \$64 billion. In comparison, the tax rate is currently 9.9 percent, borne 4.95 percent by the employee and 4.95 percent by his employer.⁴

While the tax rate is uniform for all workers,⁵ the benefits are not. They are weighted sharply in favor of the lower paid individual. Computation of benefits begins with a determination of the person's Average Monthly Earnings (A.M.E.) during his working life. To this is then applied, in effect, the following benefit schedule:

- 119.89 percent of first \$110.00 of A.M.E.
- 43.61 percent of next \$290.00 of A.M.E.
- 40.75 percent of next \$150.00 of A.M.E.
- 47.90 percent of next \$100.00 of A.M.E.
- 26.64 percent of next \$100.00 of A.M.E.
- 22.20 percent of next \$250.00 of A.M.E.
- 20.00 percent of next \$175.00 of A.M.E.

From this schedule we can see that if a worker had Average Monthly Earnings of only \$100.00, he would receive a benefit of \$119.89, or almost 120 percent of his A.M.E. At the other extreme, a worker with an A.M.E. of \$1,175 would receive only 20 percent in benefits on his top \$175.00 in earnings.

This type of benefits schedule represents society's attempt to provide a higher relative benefit for the low-paid worker. It is a recognition of "need" as a criterion, and is, therefore, a departure from the strict idea of individual equity. Another such social concept is found in the fact that a married worker receives certain protection for his dependents without paying any more tax than a single worker who receives no such protection.

The entire Social Security program is necessarily a blend of social goals and individual equity. Maintaining the proper blend is very important if we are to sustain the workers' support of the plan. To date, most workers feel responsible for the system because, while aware of the social weighting in some aspects of the program, they still view their protection as being reasonably related to the taxes they pay. This attitude is important to the success of Social Security, and should be weighed when considering the introduction of additional benefits based on need or methods of financing from general revenues.

⁴ To the 4.95 percent for OASDI is added an additional tax of .90 percent for Medicare, making the full Social Security tax 5.85 percent for both the employer and the employee.

⁵ All employees pay 4.95 percent. Self-employed persons were originally supposed to pay 50 percent more, or 7.425 percent, but their rate has been frozen at 7 percent since 1973.

B. AUTOMATIC CHANGES IN BENEFITS

In the 40 years since the OASDI was created, Congress has voted several raises in benefits. Such raises were usually expressed as a fixed percentage of the benefit schedule above, so the increase in costs was limited and could be estimated within a narrow band. When benefits were raised, tax rates were also reviewed, and they were modified to the extent necessary to provide sufficient additional revenues to meet the higher benefit requirements. From time to time Congress has also raised the maximum level of wages subject to the tax.

In 1972, Congress enacted a basic change in the law. It shifted from the ad hoc approach and provided that thereafter benefits would increase automatically in accordance with changes in the cost of living, without any action by Congress. The cost of living is to be measured by the Consumer's Price Index (CPI). The first such automatic increase is now scheduled to take place for the month of June, 1975, with the increase in benefits to be payable in early July, and to be measured by the increase in the CPI between the second quarter of 1974 and the first quarter of 1975.

In adopting the "automatic" approach, Congress was aware that, over any reasonable period of time, wage increases can be expected to be greater than increases in the CPI, although for short periods of time the opposite may be true. Higher wages will provide more Social Security taxes without any increase in the tax rate, and Congress is generally relying on this factor to provide the additional revenues necessary to balance the higher benefit costs.

Adoption of this automatic method, however, made the actuarial analysis of the system considerably more complex, because it made the cost of the system very sensitive to the relationship of changes in prices and in wages. In determining the soundness of the system, therefore, it is now necessary to estimate the movements of prices and wages for the next 75 years. This is obviously a difficult thing to do, and it has not been made any easier by the sudden appearance of inflation rates that are far beyond any recent experience.

Further complicating the forecasting problem has been the decline in the birth rate and the development of several factors that should tend to hold it at a relatively low rate in the future. The cost of the OASDI system has always been influenced by demographic factors, but the recent changes in the actual and estimated fertility rates are of much greater magnitude than those of the past, and those changes have produced the most material effect on the actuarial soundness of the plan, as discussed below.

II. TRUSTEES' REPORT OF 1974

In early 1974, the trustees of the OASDI system caused their regular actuarial review of the system to be made, and they issued a report to the Congress on June 3, 1974. We will summarize that report and then test the reasonableness of the factors upon which it is based.

The trustees' report analyzes the cost of the OASDI system over the 75-year period beginning with 1974 and ending with 2048. This

length of time is required in order for the demographic factors to be fully reflected in the costs. Like most persons, the trustees did not fully anticipate the inflationary forces in 1974 but this, in itself, does not invalidate their long-term conclusions.

A. MAJOR ASSUMPTIONS AND RESULTING DEFICIT

The trustees founded their conclusions on four major assumptions:

(1) Wage increases will fall gradually from 8½ percent in 1975 to 5½ percent in 1978 and will average 5 percent for the rest of the 75-year period. (See Exhibit I)

(2) The rise in the CPI will fall gradually from 9.1 percent in 1974 to 3 percent in 1978 and will average 3 percent for the rest of the 75-year period. (See Exhibit I)

(3) The increase in real wages will fluctuate until 1978 and will thereafter average 2 percent for the rest of the 75-year period. (See Exhibit I) Real wages are wages adjusted for changes in the CPI. This factor actually expresses the relationship between the first two assumptions, but it is set out separately because of its importance, the cost of the system being very sensitive to this relationship.

(4) The "total fertility rate" is the average number of babies born per woman during her lifetime. This rate now stands at about 1.9, which is below the replacement rate. The trustees have estimated that this will rise to 2.1 by about 1985 and will remain there for the rest of the period. (See Exhibit II) At a rate of 2.1 the population will reach 320 million around the year 2045, at which time it will be growing at only 450,000 per year, mostly from immigration.

Based upon these assumptions, the trustees have computed the cost of the system as set out in Table A, below. For comparison, the tax rate presently authorized by law has also been provided:

[In percent]

Calendar year	Cost, as a percent of total taxable payroll required to meet benefits	Combined tax rate of employer and employee under present law
1974	10.67	9.9
1985	10.44	9.9
1990	11.03	9.9
1995	11.25	9.9
2000	11.31	9.9
2005	11.69	9.9
2010	12.69	(2011) 11.9
2015	14.14	11.9
2020	15.71	11.9
2025	16.97	11.9
2030	17.60	11.9
2035	17.68	11.9
2040	17.68	11.9
2045	17.86	11.9
Average	13.89	10.91

¹ Cost.

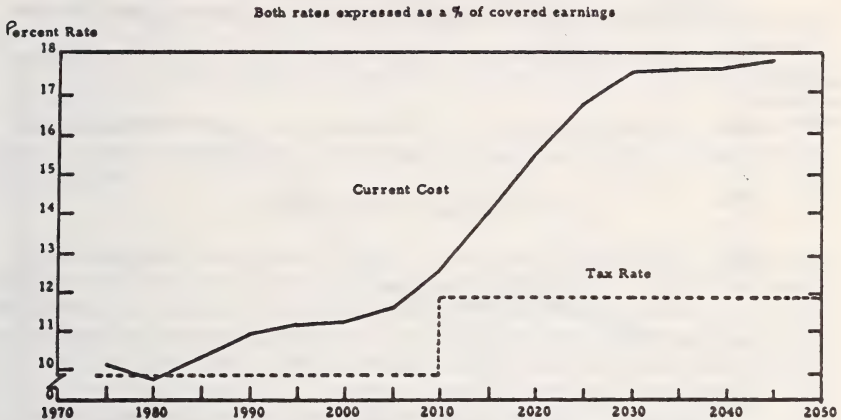
² Tax.

The difference between the costs and the tax rates above represents an actuarial deficit which averages 2.98 percent over the 75-year period.

B. SHAPE OF DEFICIT AND CAUSE

It is clear from the above that the deficit, while averaging 2.98 percent, does not occur evenly at that figure over the period. This is a vital factor in determining future tax rates, and it is even more evident in the graphic portrayal below.

PROJECTED OASDI CURRENT-COST AND TAX RATE IN PRESENT LAW, 1975-2045



The spread between the cost line and the tax line represents the deficit. From the graph we can see that if the trustees had made only a 25-year review, they would have reported a considerably smaller deficit, because most of it occurs in the later years. This "shape" of the deficit has a strong influence on the methods eventually proposed for correcting the shortfall.

While there are several reasons for this shape of the deficit, the most important one is demographic. Relatively few people were born during the great depression of the 30's. After the war, the total fertility rate rose sharply to a peak of 3.77 in 1957 and produced the war baby boom. Thereafter it began to decline and it has recently reached the very low rate of 1.9 which is below the population replacement rate. The trustees have estimated that this rate will gradually rise to 2.1, which is the rate at which the population will eventually stabilize itself, and will remain there indefinitely. (See Exhibit III)

It is this historic birth rate pattern that largely shapes the deficit. The working population has been growing rapidly as the "war babies" have entered the work force, and this will continue for some years. This means that there is a relatively large number of people who will be paying the benefits of a relatively small number of people, and for this reason the cost will not rise materially, even with automatic increases in benefits. After all of the war babies have entered the work force, costs will still rise slowly for a short period during which the relatively small number of depression babies start to draw retirement benefits.

Starting about 2005, however, the process reverses itself. Then the war babies begin to draw Social Security benefits in ever larger numbers, while the work force is not increasing at a commensurate rate

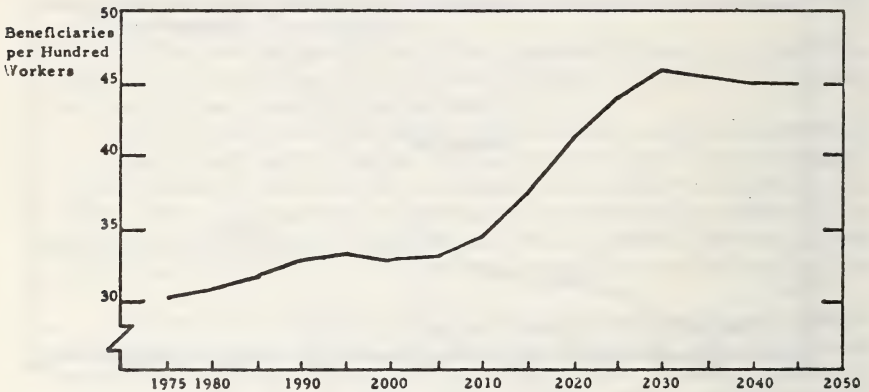
because of the low fertility rate now existing and forecasted for the future.

These demographic changes are reflected in two important statistics:

1. Today there are 30 beneficiaries for every 100 workers.⁶
2. In the year 2030 it is estimated that there will be 45 beneficiaries for each 100 workers.

This situation is more easily grasped with another graph:

PROJECTED OASDI BENEFICIARIES PER HUNDRED COVERED WORKERS, 1975-2045



It is possible, of course, that greater immigration or increased participation by women in the work force may ameliorate the problems. If not, this graph strongly suggests that around the year 2005, pressures may well develop to increase the retirement age beyond 65. This would modify the ratio between workers and beneficiaries and reduce the high tax burden that will otherwise occur. Today, of course, the general demand is to reduce the retirement age, not increase it, because the work force is expanding. By 2005, however, this factor will have been reversed under present assumptions.

Obviously the demographic projection has an almost overwhelming effect on the costs of the system. This can be seen in the table below where the 2.98 percent deficit has been broken down into its components:

Table B

	Percent of taxable payroll
Actuarial balance of OASDI estimated in late 1973.....	— .51
Effect of subsequent changes in:	
Population assumptions.....	— 1.87
Economic assumptions.....	— .19
Disability rates.....	— .21
All other assumptions.....	— .20
Total.....	— 2.47
New actuarial balance.....	— 2.98

The change in population assumptions accounts for 63 percent of the total deficit and 76 percent of the increase in the deficit since the last actuarial review.

⁶ It is interesting to note that in 1950 there were only 6 beneficiaries for every 100 workers.

III. TESTING TRUSTEES' CONCLUSIONS

An actuarial deficit of 2.98 percent presents a serious problem to the system. Before attempting to deal with it, however, we should first test its validity.

The trustees' conclusion as to the deficit depends upon the reasonableness of their four basic assumptions:

- (1) Wages will increase at an average rate of 5 percent.
- (2) The CPI will increase at an average rate of 3 percent.
- (3) Real wages will increase at an average rate of 2 percent.
- (4) Fertility rate will rise from 1.9 to 2.1 by 1985 and remain

there.

The Subcommittee has reviewed the more important data upon which these assumptions have been based and has presented its views below.

A. ECONOMIC ASSUMPTIONS

Wage increase data since 1950 is set out in Exhibit IV. There the compounded rates of increase in covered wages are shown for each year down to 1973. From the Exhibit we can see that average covered wages rose at a compounded rate of 4.76 percent from 1950 to 1973. For each of the years 1961 through 1964, the compounded rate of growth to 1973 exceeded 5 percent, and for every year since 1965, the compounded rate is above 6 percent.

Price increases since 1950 are set out in Exhibit V, which presents the compounded rate of increase for each year down through 1973. Here we can see that from 1950 to 1973, the CPI rose at a compounded annual rate of 2.70 percent. For each of the years 1959 through 1963, the compounded rate of growth to 1973 exceeded 3 percent, and the compounded rate for 1964 and every year thereafter exceeds 4 percent. In the year 1973 the CPI rose 6.23 percent and for the year 1974 we have witnessed our first double-digit rise in the CPI in recent history. We are concerned, of course, with the average over a 75-year period, and deviations from that average, even the extremes we are witnessing, do not invalidate the forecast.

There is another factor, however, which is presently unknown, but which is very important to the forecast. That is the rate of unemployment which the nation is willing to accept. We know that when that level of unemployment is exceeded, the economic pump will be primed in ways which are inflationary.

Very recently, the public and Congress have demonstrated that they will accept strongly inflationary measures in an attempt to correct an unacceptable level of unemployment, *at a time when the inflation rate is at, or close to, double digit-figures*. Without attempting to judge such a decision, it does indicate a strong bias toward inflation, vis-a-vis some levels of unemployment. This cannot be encouraging when attempting to support an estimated 3 percent level of inflation for the long-term future.

Real Wages—Even more important than the individual rates for wages and prices, is the relationship between the two. This relationship is usually referred to as the increase in real wages, and it is significant because the cost of the system is very sensitive to this factor. If, for example, wages rise by 6 percent and prices at 3 percent, real wages

will increase by about 3 percent and the cost of the system over 75 years will average 10.86 percent of covered wages. If, however, wages rise only 5 percent and prices go up by 4 percent, real wages will rise by about 1 percent and the cost of the system nearly doubles to 20.59 percent of covered wages.

Exhibit VI presents the data on real wage increases, and from IV, V, and VI we have extracted the following:

TABLE C. ANNUAL COMPOUNDED RATE OF INCREASE

[In percent]

	CPI	Wages	Real wage
1950 to 1973.....	2.70	4.76	2.00
1958 to 1973.....	2.91	4.86	1.90
1963 to 1973.....	3.79	5.58	1.72
1968 to 1973.....	5.02	6.22	1.14

In recent years the rate of increase in real wages has obviously been dropping. While some part of the drop may be due to the normal operation of the business cycle, it is doubtful that it can all be so explained. Any long-term increase in real wages is largely a function of increased productivity, and there are several developments which may have already contributed to the decline of productivity and which may continue to slow its growth in the future:

1. Continuing shift from a manufacturing economy to a service economy, with correspondingly reduced opportunities to increase productivity by the use of machines.

2. Necessity for large capital expenditures for pollution control equipment. While these provide a social benefit, they also increase the cost of goods.

3. An increase in the cost of foreign-source raw materials, such as oil, without any domestic offsets.

4. Changes in workers' goals and motivations—increased productivity subordinated to “job enrichment.”

From the information above, the Subcommittee has concluded that there is evidence upon which the trustees could reasonably base their three economic assumptions. The Subcommittee has also concluded that reasonable men might well argue from the same data and reach less optimistic projections, particularly with regard to the estimated 2 percent growth in real wages. One of the Consultants, in fact, is convinced that the growth in real wages will more likely be between 1 percent and 1½ percent. If the rate should be lower than 2 percent, the forecasted deficit of 2.98 percent would be greater.⁷

It should be emphasized that the system is also quite sensitive to inflation, alone. Even if the 2 percent increase in real wages is attained, double digit inflation can still be catastrophic. For example, if we suffered 10 percent inflation over the 75-year period and wages rose at 12 percent, the average cost of the system would exceed 24 percent and

⁷ As this is being written the Social Security staff is well along in its work on the 1975 trustees' report. It is already quite clear that the assumptions as to wage and price increases in that study will be higher than the 5 percent and 3 percent used in the 1974 study. These and other possible changes will almost certainly increase the long-term deficit that the trustees ultimately report. In addition, the Senate Finance Committee employed a panel of outside consultants to review the financing of Social Security, and in February, 1975, they concluded that the CPI would grow at 4 percent and wages at 6 percent. These factors were combined with less optimistic demographic assumptions to produce an average long-term deficit of 6 percent.

the actual cost in the year 2040 would be almost 40 percent. Figures beyond 10 percent inflation are proportionately worse, making it clear that double digit inflation can destroy the system if it continues for any prolonged period. Even a relatively modest change to 7 percent for wages and 5 percent for the CPI would more than double the deficit forecast by the trustees.

B. FERTILITY RATES

Fertility rates are the most important factor in the trustees' determination of future costs of the system, with changes in such rates accounting for some two-thirds of the prospective long-term deficit. (See page 98.) The trustees have assumed a gradual increase in the fertility rate from the present very low rate of 1.9 to 2.1 by 1985 and stabilizing at that rate thereafter. In Exhibit III there are shown the total fertility rates from 1940 to 1973, and it can be seen that such rates are nearly all above 2.1.

Fertility rates are obviously difficult to forecast with confidence because social, psychological, religious and other intangible factors can be involved. Not all of the demographic aspects, however, depend on forecasts. The persons who will draw retirement benefits between the years 2005 and 2035 are already born. We already know that the number of beneficiaries in that period will be relatively large and that total benefits, therefore, will be relatively high. What we do not know is how many people will be working in those years and paying the taxes to support those benefits. If the fertility rate does hold at 2.1, as the trustees assume, the number of workers will be relatively small and the tax rate will be high.

It must be remembered that the average person cannot be expected to pay Social Security taxes until some 18 to 20 years after he is born. This means that, in a certain sense, time is already starting to run out. The fertility rate will have to start moving well above the projected rates within the next 15 years, and remain at a relatively high level for three decades, in order to produce any meaningful reduction in the high taxes that will otherwise be payable. Working against this possibility are several developments of recent years that provide strong reasons for believing that the rate will not move above 2.1 in the foreseeable future:

1. Important advances in the technology of controlling conception and the wider use of abortion.
2. Widespread realization that the resources of the world are finite and that the population, therefore, must be stabilized.
3. Concern for overcrowding and its impact on the quality of life.
4. Changes in life style, with many more married women who work.

Your Subcommittee believes that these factors and the statistical data provide reasonable support for the fertility rate assumptions made by the trustees. The possibility of error is always present, but there is no reason to believe that the assumptions have been bent toward the gloomy side, and two of the Consultants believe they may be too optimistic.

C. SUMMARY OF ANALYSIS

In summary, the Subcommittee finds that there is evidence from which the trustees could reasonably have determined in 1974 that there is an estimated long-term actuarial deficit of 2.98 percent in the OASDI plan. It is recognized that such deficit is necessarily based on forecasts of factors that cannot be predicted with any certainty. There is no evidence, however, that the trustees were pessimistic in their conclusions, and, with the benefit of some hindsight, the Subcommittee believes that the actual deficit is more likely to be higher than lower. In fact, the sharp rise in the CPI that has already occurred, will automatically result in an increase in the deficit, as discussed later herein. (Also see footnote on page 100.)

The Consultants generally concur in the above broad conclusions. They also recognize the extreme difficulty of forecasting the controlling factors over a 75-year period. While not unanimous in their opinions on individual factors, they have found the trustees' estimated deficit to be "a reasonable indicator of future experience."

Both the Subcommittee and the Consultants agree that it is not enough to merely state that the average deficit is 2.98 percent. The shape of the deficit curve over time is very important. (See graph on page 97.) There is relatively little deficit predicted for the first three decades—nothing like 2.98 percent. The larger shortfalls, approaching 6 percent, occur thereafter, when forecast errors are more likely. This must influence the kind of steps that are taken to correct the deficit.

IV. SIZE OF THE OASDI TRUST FUND

There is a collateral question, related to the deficit problem, and that is: "At what size should the OASDI trust fund be maintained?"

As stated at the outset, the program is not "funded," in the sense of expecting the fund to provide all or a substantial part of future benefits. The fund is intended to operate only as a sort of surge tank, receiving all income, disbursing all outgo and leveling out the variations between the two. It is designed to cope with the fact that there are seasonal variations in income, as compared to a fairly evenly rising expenditures level. The fund is also intended to assure payments in the case of economic recession or periods of relatively high unemployment when tax collections might be temporarily diminished.

The present fund approximates \$50 billion, or about 67 percent of one year's expenditures. Since the expenditures increase every year, the fund must also increase, in absolute terms, if it is to maintain the same ratio to expenditures. Based on the trustees' assumption, by 1978 the fund will be equal to only about 48 percent of one year's expenditures. As discussed later, herein, subsequent events now indicate that it will have fallen below 35 percent. It is possible that even this figure may be adequate for the fund's purpose, but it is not considered sound by the Subcommittee to permit it to deteriorate to that level. At the very least, such a decline in the ratio would probably cause real concern among workers and beneficiaries.

The 1971 Council recommended that the fund be maintained at a level of about one year's benefits, being free to fluctuate between

.75 and 1.25 thereof. Such a fund would certainly be adequate, but it is clearly an arbitrary range.

In comparison to the deficit problem, the size of the fund is not of great importance so long as it does not fall too low. Your Subcommittee, therefore, does not believe that a separate change should be made now just in order to raise the fund quickly to some percentage. Instead, in our proposals for coping with the deficit, we have built in a very small element that will stabilize the fund at about 55 percent of one year's outgo until 1980 and will thereafter raise it very gradually to 100 percent.

V. DEFICIT INCREASE DUE TO BENEFIT INCREASE FOR JUNE, 1975

Our primary problem is covering the deficit, but the 2.98 percent, forecasted by the trustees, is not the full amount. There are other factors which add to and subtract from that deficit, and which must be included in any proposed solution. One of these factors is the effect of the unexpectedly high benefit increase for June of 1975.

Under the present law, benefits are scheduled to rise automatically with the CPI. The first such automatic increase will occur for the month of June, 1975, and will be measured by the rise in the CPI between the second quarter of 1974 and the first quarter of 1975. The trustees originally estimated in early 1974 that such increase would be 4.4 percent. It is now estimated that the increase will be 8.5 percent, and this, in turn, will cause an increase of .5 percent of covered wages in the estimated long-term deficit.

It is important to note that this increase in the deficit has an immediate impact on the cost of the plan. It is not deferred like so much of the 2.98 percent deficit computed by the trustees. Provision for this portion of the deficit cannot be long delayed.

VI. CORRECTIVE PROPOSALS

The Subcommittee believes that certain basic changes are needed in the system. In addition, the Council has voted to recommend certain changes in the benefit structure. Since all of these modifications affect the amount of the deficit, they must be discussed first, before coming to grips with the problem of covering the deficit, itself.

A. REVISED BENEFIT FORMULA TO STABILIZE REPLACEMENT RATIOS

A "replacement ratio" is the relationship between a worker's monthly benefit and the monthly wage he earned just before he retired, died, or was disabled. Thus, if a worker earned \$600 per month just before retirement and received a monthly benefit of \$300, he would have a replacement ratio of 50 percent. Replacement ratios are a very important criterion of the effectiveness of an earnings replacement system, and they should be stable over long periods of time, even though absolute benefit levels will naturally continue to rise with wages and prices.

At present the OASDI system contains a flaw which was probably never intended and which can cause replacement ratios to fluctuate widely, both up or down, depending on future movements of wages

and prices. The Subcommittee's first, and most important, proposal is to redesign the benefit computation system in such a way as to eliminate the flaw and thereby stabilize replacement ratios.

It is strongly emphasized that the proposal is not designed to reduce benefits. Some writers have mistakenly publicized it as such, because they failed to understand that the present flawed system can also produce lower benefits than the corrected system, depending on the future movements of wages and prices.

To understand the flaw and its correction requires a rather lengthy explanation, beginning with the manner in which benefits are now determined.

1. PRESENT SYSTEM

Today the starting point in computing the benefit of an individual is the determination of his or her Average Monthly Earnings, usually referred to as the A.M.E.⁸ The process begins with his actual taxable earnings for every year after 1950, down to and including the year before the year in which retirement occurs. Assuming that he retires in 1974 at age 65, he would have 23 years of coverage. From these 23 years, the highest 18⁹ are then selected and added together to determine the total *actual* earnings. This figure is then divided by 18 and the quotient is further divided by 12 to obtain the A.M.E.

The monthly benefit is then determined, in effect, by applying the benefit schedule to the A.M.E. This benefit schedule, as stated earlier, is weighted in favor of the lower paid beneficiaries, as follows:

Present Benefit Schedule

119.89 percent of first \$110.00 of A.M.E.
43.61 percent of next \$290.00 of A.M.E.
40.75 percent of next \$150.00 of A.M.E.
47.90 percent of next \$100.00 of A.M.E.
26.64 percent of next \$100.00 of A.M.E.
22.20 percent of next \$250.00 of A.M.E.
20.00 percent of next \$175.00 of A.M.E.

With this kind of formula, the ratio of the benefit to the A.M.E. will depend upon the level of earnings, with the low paid beneficiary receiving a substantially higher benefit ratio than the high paid beneficiary. This also means that the replacement ratio of the lower paid worker will exceed that of the higher paid. Here are three representative examples:

Table E

	Replacement ratio (retirement at age 65 in 1975)
Worker with 1974 earnings of \$3,200.....	¹⁰ .611
Worker with 1974 earnings of \$7,681.....	.426
Worker with 1974 earnings of \$13,200.....	.294

The low paid worker above receives a benefit that is 61 percent of his earnings just before retirement, while the high paid worker receives

⁸ Formerly referred to as Average Monthly Wage (A.M.W.) but changed to A.M.E. so as to include earnings of the self-employed.

⁹ The number of years included in the computation will be 19 for men attaining age 65 between 1975 and 1978, and will rise by one year for each year thereafter starting in 1979, until the maximum divisor of 35 years is attained in 1994. At present, the system for women is slightly different, but follows the same principle.

¹⁰ If the workers in the above example had wives who were 65 or over, the replacement ratios would each be 50 percent higher, or .917 in the case of the low-paid worker.

only about 29 percent to 34 percent. In absolute dollars, of course, the higher paid worker still receives a larger benefit.

While not significant in the problem being discussed, it should be pointed out that the above replacement ratios are understated by the effect of income taxes, especially in the median and maximum wage levels. Social Security benefits are not subject to income taxes, but the wages before retirement are. Therefore, to compute a more accurate replacement ratio, one should reduce the wages before retirement by the related income taxes, and this amount should then be compared to the untaxed benefit. The same type of understatement occurs in all three wage levels to the extent that there are work-related expenses which are eliminated after retirement.

2. INSTABILITY OF REPLACEMENT RATIOS

Our major concern here, however, is that the replacement rates, however computed, are not constant. Under the present system they tend to move over time with changes in the wage and price levels. To illustrate this point, we have set out below the same three examples shown in Table E, but now we have projected those replacement ratios into the future under the assumptions employed by the trustees of 5 percent wage increases and 3 percent CPI increases.

TABLE F

	Replacement ratios of 3 workers assuming annual increases of 5 percent in wages and 3 percent in CPI		
	Low earnings	Median earnings	Maximum earnings
Year of attaining age 65:			
1975.....	0.611	0.426	0.294
1985.....	.608	.452	.333
2000.....	.657	.456	.337
2025.....	.799	.495	.364
2050.....	.855	.519	.379

This illustrates the basic instability of the replacement ratios, using the trustees' assumptions. If we modify those assumptions we can demonstrate that the potential instability is much worse. In the table below we have used the same 5 percent wage increases but we have changed the price assumptions and produced drastic swings in the replacement ratios:

TABLE G

	Replacement ratios if wages grow at 5 percent and CPI at various rates					
	Low earnings		Median earnings		Maximum earnings	
	CPI up 4 percent	CPI up 2 percent	CPI up 4 percent	CPI up 2 percent	CPI up 4 percent	CPI up 2 percent
Year of retiring:						
1975.....	0.615	0.606	0.430	0.423	0.294	0.292
1985.....	.675	.547	.501	.407	.370	.300
2000.....	.843	.511	.585	.355	.429	.265
2025.....	1.299	.489	.770	.318	.541	.247
2050.....	1.647	.445	.916	.300	.627	.237

If the inflation rate is 4 percent, instead of 3 percent, the replacement rate for the low earner will grow from .615 to 1.647, and he will receive a benefit that is more than 60 percent above his final earnings level.¹¹ On the other hand, if the inflation rate is 2 percent, his replacement rate in 2050 will be only 27 percent of what it would have been under a 4 percent inflation rate.

The above table presents the problem with great clarity. Replacement ratios can move capriciously, either up or down, and they can move in a broad range depending upon the movements of prices and wages, two factors over which the system has no control. This is a very undesirable characteristic in the system and was probably never intended.

Why does this instability occur? The answer is found in the way in which the benefit increase mechanism functions.

Whenever the CPI rises under today's system, benefits will automatically rise. The increase in benefits is accomplished, in effect, by raising the entire benefit schedule, which is set out at the top of page 104. If the CPI rises 8 percent, then each of those percentages on page 104 will move up by 8 percent. This increases the benefits for all persons who are already retired, but it also increases the future benefits for those who are still working, because they will eventually obtain the advantages of the higher benefit schedule when they retire. At the same time, however, those who are still working will also receive an increase in wages, and this will increase their A.M.E. and thereby further increase their future benefits. In other words, the benefit increases for those still working are "coupled" with the benefit increases for retired persons, and this produces the instability in replacement ratios which is illustrated above.

To stabilize the replacement ratios, then, requires that the system be "decoupled." The Subcommittee and the Consultants both strongly recommend that this be done by adopting a new method of computing benefits based on indexed earnings and a revised benefit formula.

3. PROPOSED NEW SYSTEM

The basic requirement of the new system is that a person's benefits shall rise solely in accordance with wages during his working years and shall rise solely in accordance with the CPI in years after his retirement. It must be emphasized that this can be accomplished by more than one formula, and the choice thereof will have to be worked out by the Congress with the advice and assistance of the Social Security Administration in accordance with whatever specific objectives are eventually selected. The Consultants have assured us that a decoupled system can be designed so as to prevent any material change in current benefit levels or replacement ratios. If desired, it can even be implemented so that there is no change except for the better. The design and installation of such a system will take some time because careful testing will be required, and the specific formula adopted will depend upon the year it actually goes into operation.

We have presented below an illustrative plan that will decouple the system and will attain certain other objectives¹² which the Council

¹¹ If he has a wife over 65 years of age, they will receive a benefit that is 50 percent greater, and this will provide a replacement ratio of 2.47 percent.

¹² The Council has voted to recommend freezing the minimum benefit and eliminating any benefit level that exceeds 100 percent. Both of these concepts influence the design of the benefit formula.

has recommended. We emphasize again that our presentation below is illustrative and that there are different approaches to the problem, the ultimate selection being dependent on the objectives to be attained and the date of installation.

a. Indexed earnings

On page 104 we explained how benefits are presently computed by first determining the A.M.E. The decoupled system will begin with a substantial change in this computation. Instead of employing the actual taxable amounts earned after 1950, those actual earnings will first be indexed to the year before retirement. That means that the earnings of each such year will be multiplied by a factor which represents the growth in average covered earnings. Let us assume, for example, that a man retires in 1974 at age 65. If he earned \$3,500 in 1960 and the average 1973 covered wage is 80 percent higher than the average 1960 covered wage, then the employee's earnings of \$3,500 will be multiplied by 1.8 and the resulting \$6,300 will be used as his earnings for 1960 in computing his A.M.E. This same procedure will be applied to each year in his working history. The highest 18 years, thus indexed, would again be selected, added together, and then divided by 18 and that quotient divided by 12 to obtain the Average Monthly Indexed Earnings, referred to as A.M.I.E.¹³

b. New benefit formula

This A.M.I.E. will always be higher than the A.M.E., formerly used, and will usually be substantially higher. Therefore, it would be improper to use the schedule of benefit percentages used under today's method. Instead, a new formula has been developed which can be expressed as follows:

A percent of the first \$*X* of A.M.I.E.

plus

B percent of all A.M.I.E. over \$*X*

The numbers represented above by *A* and *B* are fixed, but the *X* would increase in future years as average covered wages increased.

The fixing of the exact amounts of *A* and *X* and *B*, in the above formula, will depend on the objectives to be met, as ultimately determined by Congress. They will also depend on the actual date on which the new system is installed. If the system became effective in 1976 and was designed to meet the Council's stated benefit objectives, here is an approximation of the formula in numerical terms:

100 percent of the first \$123 of A.M.I.E.

plus

31 percent of all A.M.I.E. above \$123

(The \$123 is adjusted upward each year as average covered wages rise.)

¹³ This indexing of earnings will have desirable benefits of its own, in addition to forming an essential part of the new system. Today, persons with comparable earnings experience can have quite different benefits because their working careers occurred in different periods. The Council's report develops this idea at length in Section 2 of Chapter 3.

Again it is emphasized that this specific formula is presented here solely to facilitate discussion and not to indicate that it is the only one that can be used, or even that it is the best. There is some opinion, for example, to the effect that a three-step formula would be better.

It must be kept in mind that this formula will be applied to an amount which generally will be well above the actual earnings of the person involved. His low earnings back in the 1950's and 1960's will all have been indexed up to the year before retirement. If his A.M.E. under the present plan would have been \$300, his A.M.I.E. could be \$450 or more under the proposed plan. With an A.M.I.E. of \$450, he would receive a benefit of \$123 from the first line of the above formula and 31 percent from the second line, or a total of \$224.

The \$123 figure in that formula must increase with the rise in average covered wages. That is an essential factor in stabilizing replacement ratios under the system, and that is the basic objective of the new proposal.

The decoupled system, proposed above, will not freeze benefits in any sense of the word; it will merely stabilize the relationship of those benefits to the earnings of the recipient before retirement. Furthermore, the proposed system can be implemented in such a way so as not to reduce anyone's benefits as computed under the presently existing formula.

It is most unfortunate that decoupling is sometimes described as a reduction in future benefits. This is a misleading and unwarranted description. Whether the decoupled system would produce lower or higher benefits than the present system depends upon the relationship between future movements of wages and prices, factors which no one can predict with certainty. Under the assumptions of the trustees as to wage and price increases, the long-term cost of the proposed system will not be as high as the present plan, but if the movements of wages and prices follow a different pattern, the benefit level, and therefore the cost, could be higher under a coupled system than under the present system.

The primary advantage of the proposed decoupled plan is that the replacement ratios will be stabilized. This is a very desirable goal of an earnings replacement system, and this is the reason it should be adopted. The proposed method will also provide an important collateral benefit in that it will protect the OASDI program against high inflation rates, providing that increases in real wages do not fall materially below 2 percent.

In summary, the new formula will cause benefits to rise solely in keeping with wages during an individual's working years, and after retirement his benefits will increase solely on the basis of increases in the CPI. The Subcommittee strongly recommends that such a decoupled system be adopted. In fact, the Subcommittee is convinced that decoupling is by far the most important step to be taken to improve the system.

B. CHANGES IN BENEFITS

The Council voted to recommend six changes in benefits, three of which will increase the cost of the system and three of which will reduce the cost. Each of these changes is described below:

1. NO BENEFIT RATE TO EXCEED 100 PERCENT

The present benefit schedule, as set forth at the top of page 104, provides benefits in excess of 100 percent of the first \$110.00 of the A.M.E. As stated earlier herein, this is a recognition of "need" as a criterion in determining benefits. It is also a recognition of the fact that, when the system uses actual earnings in determining the A.M.E., the benefit percentage may have to exceed 100 percent in order to provide a reasonable replacement of purchasing power at retirement. With the use of indexed earnings in the proposed decoupled system, this requirement disappears, and the Council therefore believes that the new system should not furnish a benefit in excess of 100 percent of any part of the earnings it is intended to replace. For this reason the proposed new system does not provide any benefit percentage higher than 100 percent. See proposed formula on page 107.

2. FREEZING THE MINIMUM BENEFIT

The present system contains a minimum benefit of \$93.80, which is payable to anyone who has a certain number of quarters of coverage under the Social Security system, regardless of his A.M.E. This is another recognition of "need" as a criterion. At present, this minimum benefit rises each year in accordance with the rise in the CPI. The Council has voted to freeze the minimum benefit at \$93.80, because there is another system now in operation that will cover the "need" cases. They refer to the Supplemental Security Income program (SSI) which provides a minimum income of \$146 per month for an individual and \$219 for a couple. These amounts will rise as the CPI rises. This program is based purely on need and is, therefore, funded entirely from general revenues of the Treasury Department.¹⁴ With this alternative, the Council feels that it is no longer necessary to maintain the present minimum benefit, and freezing it will cause it eventually to disappear.

3. LIBERALIZATION OF THE RETIREMENT TEST

Under the retirement test today, a retiree loses one dollar of benefits for each two dollars he earns above the permitted amount, which is \$2,520 in 1975. Such permitted amount rises each year with average covered wages. The Council has recommended that for earnings above the permitted amount, but not in excess of twice the permitted amount, the loss of benefits be limited to one dollar for each three dollars of earnings. For earnings above twice the limited amount the one-for-two reduction in benefits would again apply.

4. LIBERALIZATION OF THE DISABILITY TEST

The Council has recommended a liberalization of the disability test by proposing a somewhat less stringent test for those who are 55 years of age and older.

5. EQUALIZING DEPENDENCY REQUIREMENT

When a woman dies, her surviving spouse does not receive any survivor benefit unless he can prove dependency on his wife. Since a

¹⁴ SSI is not really a part of the Social Security system but is administered by the Social Security Administration solely because it has the organization necessary to handle the mechanics of distributing the benefits.

surviving wife need not prove dependency, the Council has voted to recommend that this requirement be eliminated so as to provide equal treatment of the sexes.

6. ELIMINATING CERTAIN DOUBLE BENEFITS

Some persons, who have worked in non-covered employment and have earned benefits thereunder, also earn secondary benefits under Social Security. The Council has voted to reduce the latter by the former.

The net financial effect of these proposed changes is an increase in the deficit of .13 percent of covered wages. Due to the nature of the changes, at least part of this increase will be felt immediately. Its impact will not be delayed.

C. TAX ON THE SELF-EMPLOYED

The "cost" of an employee's benefit is paid for by both the employee and his employer, with each paying 4.95 percent today, or a total of 9.9 percent. The self-employed person receives the same benefits as an employee, and logically he should pay the same total tax of 9.9 percent. However, it was decided long ago to reduce his tax to 75 percent of the combined tax, which is the same as 150 percent of the employee's tax. This means he should be paying 150 percent of 4.95 percent or 7.425 percent. In recent years, however, his rate has been further reduced by being frozen at 7 percent, and the Subcommittee sees no reason for this additional deviation from the full 9.9 percent. It is recommended that the self-employed tax be fixed at 150 percent of the employee's tax, and all future tax rate calculations in this report are based on that proposal.

D. COMPULSORY COVERAGE OF GOVERNMENT EMPLOYEES

Some 90 percent of the working population is today covered by Social Security. By far the largest segment that remains uncovered is composed of government employees, federal, state and local. The Council has recommended that Social Security coverage of these employees be made compulsory in order to prevent the windfall benefits which they frequently receive at the expense of the Social Security system. (This windfall problem is described in greater detail in Section 1 of Chapter 6 of the Council's report.)

If all government employees were brought under Social Security, it is estimated that there would be a long-term reduction in the cost of the system of .25 percent of covered wages and a short-term reduction of .70 percent. These are significant amounts, but there are also significant obstacles to such compulsory coverage. A constitutional question clouds the forced coverage of employees of state and local governments, and neither Congress nor the federal employees have ever indicated any inclination to accept the idea. For these reasons, the Subcommittee, while fully in favor of covering all government employees, has decided not to include such potential cost reductions in our later computations of the deficit.

E. FINANCING MEDICARE (PART A) FROM GENERAL REVENUES

Up to this point we have been considering only the OASDI system. It is timely here to present a recommendation of the Council which affects Part A of the Medicare program, because that proposal does concern, at least indirectly, the financing of OASDI.

The OASDI program is financed from taxes on wages, because the benefits of the program are always related to the wages of a worker-taxpayer. It is obvious that benefits are wage-related in the case of the retirement of a worker-taxpayer. It is not so obvious, but it just as true, in the case of a beneficiary who is a survivor or a spouse, because those benefits are still measured by the wages of the person who paid the tax, albeit not the wages of the beneficiary.

The same principle does not apply to benefits under the Medicare program. There the benefits are determined by the medical costs of a particular person, and they bear no relationship whatsoever to his wages or those of anyone else.

Under such circumstances there does not seem to be any real reason for funding such costs by a tax on wages. Medicare expenditures would seem to be more properly funded from general revenues, and a majority of the Council has voted to recommend such a proposal to the Congress. If adopted it could make an important contribution to the solution of the financial problems of the OASDI program.

In the next section of this report it will be established that an increase in the OASDI tax is required at this time to preserve the financial integrity of the system. If the financing of Medicare is partly shifted to general revenues now, the increase in the OASDI tax can be accommodated without increasing the total Social Security tax. A plan for doing so is presented later herein.

VII. FINANCING THE OASDI DEFICIT

The most pressing problem facing OASDI is the substantial, long-range, actuarial deficit. In 1974 it was estimated by the trustees at 2.98 percent, but subsequent events and certain proposals of the Council require that we recompute it in order to ascertain its true dimension.

A. RECOMPUTATION OF THE DEFICIT

In the table below there is presented a summary of the various items which will make up the deficit as of January 1, 1976. This date has been chosen as the earliest possible date on which all of the assumed events can have occurred. The "minus" sign is used in the table to indicate a deficit or an increase in the deficit. The table assumes that:

1. The automatic benefit increase for June, 1975, will take place;
2. The Congress will adopt and install a new "decoupled" method of determining benefits along the lines suggested on pages 106 and 107 above;
3. The six proposals of the Council on pages 109 and 110 above, will be adopted by Congress;

4. The self-employed tax is set at 150 percent of the employee's tax;

5. Compulsory coverage of government employees is not enacted.

Table H.—Change in actuarial balance of OASDI expressed as a percent of taxable payroll

Item	Average cost
Actuarial balance from 1974 trustees' report.....	-2.98
Automatic benefit increase for June, 1975 assumed to be 8.5 percent instead of 4.4 percent.....	-.51
	<u>-3.49</u>
Changes recommended by council:	
1. New method of computing benefits to stabilize replacement ratios ("decoupled" system).....	1.12
2. No benefit percentage over 100 percent and minimum benefit frozen at \$93.80.....	.07
3. Change in retirement test.....	-.02
4. Change in disability test.....	-.13
5. Equalize dependency requirement for men and women.....	-.11
6. Reduce secondary benefits by benefits from non-covered employment.....	.03
7. Unfreezing self-employed rate.....	.03
	<u>.99</u>
Actuarial Balance as of January 1, 1976.....	-2.50

Under the above assumptions, then, our task is the covering of a long-term, average deficit of 2.50 percent of covered payroll. The 2.50 deficit arises from the difference between the estimated costs of the system and the tax rates in the present law. The recomputed costs, based on the same assumptions as are contained in Table H, and employing the trustees' economic and demographic projections, are shown below, along with the tax rates in the present law:

TABLE I

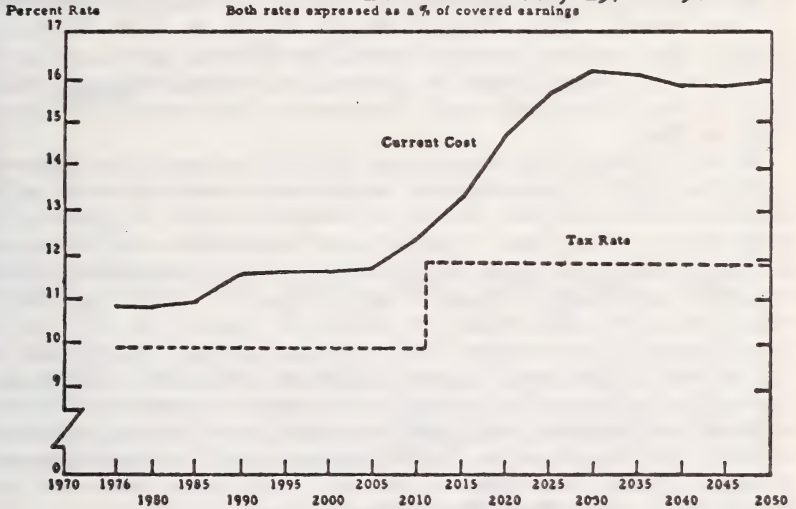
Calendar year:	Cost, as a percent of total taxable payroll required to meet benefits	Combined tax rate of employer and employee under present law
1975.....	10.9	9.9
1985.....	11.0	9.9
1990.....	11.6	9.9
1995.....	11.7	9.9
2000.....	11.7	9.9
2005.....	11.8	9.9
2010.....	12.4	¹ 11.9
2015.....	13.5	11.9
2020.....	14.8	11.9
2025.....	15.8	11.9
2030.....	16.2	11.9
2035.....	16.1	11.9
2040.....	15.9	11.9
2045.....	15.9	11.9
2050.....	16.0	11.9

¹ Calendar year 2011.

It will be noted that the cost rates in the early years are actually somewhat higher than those projected by the trustees in Table A on page 96. The costs in the later years, however, are lower than those in Table A. The reason for this phenomenon lies in the fact that the higher-than-expected rise in benefits in 1975, coupled with benefit changes voted by the Council, have raised the *immediate* costs of the system above those determined by the trustees. On the other hand, the change in the method of computing benefits (decoupled system) has prevented the escalation of replacement ratios in the next century and has thereby held the costs for that period below those estimated by the trustees.

It is quite apparent that there are really two deficits, one long-term and the other short-term. Since each has, to some extent, different causes, they require different solutions. A clearer picture of the problem can be obtained from the graph below.

**PROJECTED OASDI CURRENT-COST UNDER ADVISORY COUNCIL
RECOMMENDATIONS AND TAX RATES IN PRESENT LAW, 1976-2050**
Both rates expressed as a % of covered earnings



In the graph the deficit is represented by the spread between the cost line and the tax line.

B. LONG-TERM DEFICIT

The long-term deficit, occurring after 2005, has its roots in the demographic projection as explained on pages 97 and 98. Whether that deficit actually occurs will depend on the validity of the estimated future fertility rates and their effect on the composition of the population. It is very difficult to forecast fertility rates with any confidence and the Subcommittee recognizes that they are always subject to error. For that reason the Subcommittee's recommended tax rate schedule, below, does not contain any immediate increase in order to

handle the long-term portion of the deficit. Such increases are scheduled for later years when the cost increase has been more clearly established.

If all of the various assumptions are borne out, this delaying approach will result in a higher eventual tax rate than we might obtain by an immediate increase now of 2.50 percent. However, the latter procedure would be quite inconsistent with the "current cost" method of financing the OASDI program, because the taxes collected would immediately exceed expenditures by a substantial amount, and a large surplus would be created.

C. SHORT-TERM DEFICIT

The short-term deficit does require an increase of 1.0 percent in the OASDI tax rate at this time. This means an increase of .5 percent for both the employer and the employee. This increase should not be delayed because the deficit is already here, not in the future. It arises from several factors, such as the 8.5 percent increase in benefits scheduled for mid-1975 and the various benefit changes recommended by the Council. These factors are not delayed in their effect on the system; they cause a prompt increase in the cost and must be offset by higher tax rates. Based on present projections, the rate will also have to rise by an additional .2 percent in 1980 and by a .7 percent more in 1985.

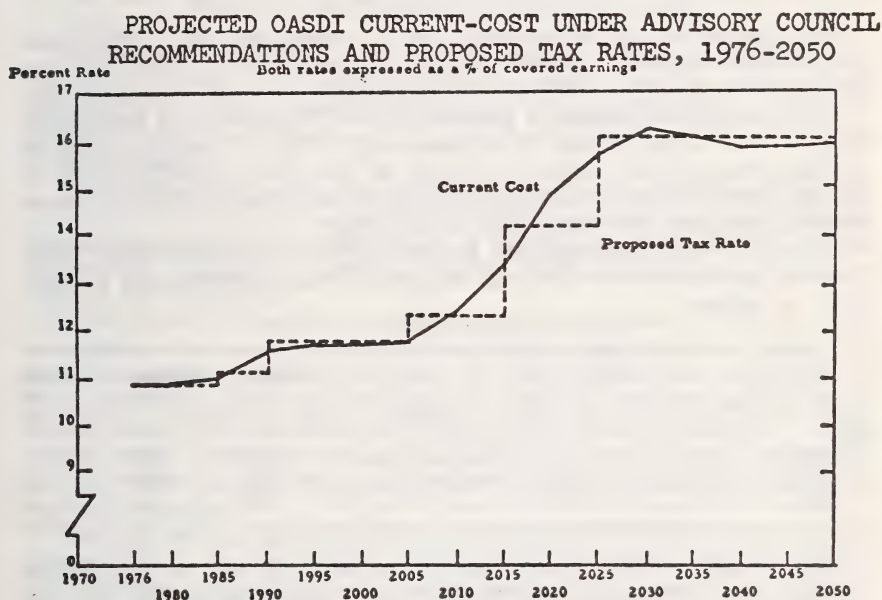
If the 1.0 percent increase in the OASDI tax rate is not enacted by 1976, the OASDI fund will start to go down in absolute terms by some \$3 or \$4 billion per year. It will go down even more in relation to the expenditures for a year, because those expenditures will be rising by \$3 or \$4 billion per year. This produces a double-barrelled effect on the important ratio of the fund to expenditures. Today the trust fund stands at about \$50 billion, or about 67 percent of one year's expenditures. If the tax rate is not increased, the fund will fall below 35 percent of one year's expenditures by early 1978. Even at this level, the system could probably still meet its payment obligations without interruption, but it will certainly cause concern among both workers and beneficiaries. Furthermore, there is no sound reason for letting the fund deteriorate in that way. The deficit exists and should be met with a reasonable tax increase.

D. PROPOSED TAX RATES

Having in mind both the long and short-term deficits, the Subcommittee now proposes a new tax schedule that will handle the total problem:

	<i>Proposed tax rate expressed as a percent of covered wages</i>
1976-1984.....	10.9
1985-1994.....	11.1
1995-2004.....	11.8
2005-2014.....	12.3
2015-2024.....	14.2
2025-2050.....	16.1

These proposed rates approximate the estimated cost curve. In this way no increase in the tax is provided before it is actually needed, and if future trends differ from the various assumptions herein, the rate can be modified before the fund has risen too high or fallen too low. In the graph below we have presented both the new cost curve and the proposed tax rate structure so that the relation of the two can be clearly seen:



It is recognized that an increase of 1.0 percent in the OASDI tax is a significant increase, but the direct impact on the taxpayer can be eliminated through the implementation of the Council's proposal to fund at least part of the Medicare program from general revenues. This is explained in the next section.

E. TOTAL SOCIAL SECURITY TAX RATES

The present Social Security tax is composed of two parts:

[In percent]

	Employee pays	Employer pays	Total tax
OASDI.....	4.95	4.95	9.9
Medicare.....	.90	.90	1.8
Total.....	5.85	5.85	11.7

If the OASDI tax rate is raised in 1976 by 1.0 percent, per the Subcommittee's recommendation, and if an equivalent amount of the Medicare program is funded from general revenues, the total Social Security tax would remain the same. It would work as follows:

116

[In percent]

	Present social security tax	Proposed social security tax
OASDI.....	9.9	10.9
Medicare.....	1.8	.8
Total.....	11.7	11.7

For the individual or the employer it means that the OASDI tax would rise from 4.95 percent to 5.45 percent but his Medicare tax would fall from .9% to .4%, thereby leaving his overall tax the same.

There would still remain a Medicare tax of .8 percent as a part of the total Social Security tax. The financing of this .8 percent could be shifted gradually to general revenues as the cost of OASDI rose in future years, thereby making it possible to keep the total Social Security tax constant for some time in the future.

In actual fact, the medicare portion of the tax is scheduled under present law to rise over the next ten years from 1.8 percent to 3.0 percent, as follows:

[In percent]

	OASDI tax	Medicare tax	Total tax
Year:			
1975-77.....	9.9	1.8	11.7
1978-80.....	9.9	2.2	12.1
1981-85.....	9.9	2.7	12.6
1986-.....	9.9	3.0	12.9

The schedule above shows that, even without any change in the OASDI tax, the total Social Security tax would rise in the next ten years from 11.7 percent to 12.9 percent. This means that if the total Medicare burden is gradually shifted to general revenues, the OASDI tax can be raised in the future by an aggregate of 3.0 percent (instead of 1.8 percent) without raising the total Social Security tax beyond the rate that would have been payable under the present law.

It is recognized, of course, that many persons and employers would incur an increase in their income taxes or other levies in order to provide the additional general revenues for the Medicare program. Depending on how this need is met, it is quite possible that for some it would mean only a shift in the type of tax that is paid. Some might even incur a higher total tax burden than they would if the OASDI tax were simply increased. However, to the extent that general revenues are derived from progressive taxes, those in the lower economic group would almost certainly benefit from the shift of the Medicare tax to general revenues. These groups would have the greatest difficulty in handling an increase of .5 percent in their Social Security tax. For many of them that tax is already a larger burden than the income tax.

VIII. OTHER CONSIDERATIONS

In addition to the proposals discussed above, the Subcommittee also considered other approaches to the deficit problem. One of these, involuntary coverage of government employees, has already been covered. Two others are presented below.

A. RAISING THE MAXIMUM COVERED WAGE

Today, only earnings up to \$14,100 per year are covered by Social Security. Under the automatic changes in the law, this amount will rise each year in the same proportion as average wages rise. This will gradually increase the amount of maximum taxable earnings over the years to come.

There is nothing sacred in the figure, \$14,100; it is largely arbitrary. To help cover the deficit, the Subcommittee, at one point, considered raising the maximum covered wage to \$24,000 per year in 1976. It was eventually abandoned because there were formidable arguments against this proposal.

Social Security was designed from the beginning as only one of three elements in the income-maintenance system, the other two being: (1) private savings, pensions, etc., and (2) public assistance programs. It was logically argued that raising the limit to \$24,000 would cause Social Security to interfere with the private savings element. It certainly would extend coverage to a level of income where "enforced" savings seems inappropriate, and where it could further reduce needed capital formation.

The only real argument in its favor was that it would hold down the increase in the tax rate which is necessary to cover the long-term deficit. If it were adopted, it would cut the short-term deficit by .89 percent and the long-term deficit by .49 percent.

B. INCREASING THE RETIREMENT AGE

The cost curve in the graph on page 115 indicates substantially higher costs after the year 2005, and this will require substantially higher taxes at that time. The high costs and taxes are due to the sharp changes after 2005 in the ratio of workers to beneficiaries, as described on pages 97 and 98. If it is desired to minimize those later tax rate increases, the Subcommittee recommends that serious consideration be given to gradually extending the retirement age, starting in the year 2005.

The Subcommittee is well aware that today most social and economic pressures are directed toward *reducing* the retirement age. Those pressures arise, however, because the work force is now growing, and there are only 30 beneficiaries for every 100 workers. By 2005, the situation will have reversed, and the number of people drawing benefits will be growing proportionately faster than the number of people paying taxes. By the year 2030 there will be 45 beneficiaries for every 100 workers, and the tax burden on the workers will have risen sub-

stantially to meet the costs in Table I. In such a situation, and given the expected advances in health care and longevity, it seems sensible to at least consider some modest increase in the retirement age so as to maintain a reasonable ratio of workers to beneficiaries and thereby hold down the tax rates.

As an example, it is suggested that every six months the retirement age be increased by one month, beginning in 2005 and ending in 2023. In the latter year, then, the retirement age would have been increased to 68 and the "early" retirement age increased to 65. If adopted, this proposal would reduce the tax rates as follows:

Year:	Tax rate proposed	Tax rate if retirement age raised to 68 by 2023	
2005-14	12.3		12.1
2015-24	14.2		13.5
2025-50	16.1		14.6

CONCLUSION

In its various proposals the Subcommittee has tried to devise a reasonable, balanced program for improving the system and coping with the deficit. This program is by no means the only approach to the problem, and others may prefer a different timing of the tax increases or a different choice of remedies.

The important fact is that the OASDI system does face a very real short-term deficit and a projected long-term deficit. Plans should be developed now for dealing with these problems. The fact that a large part of the deficit occurs in the future is no reason for complacency or delay. If the economic or demographic factors deviate from the forecasts, the corrective action may have to be modified, but that can more easily be done if an adequate program already exists. In this connection, it is worth repeating the Subcommittee's conclusion that such deviations are more likely to increase the deficit than decrease it. Our most recent experience only strengthens that conclusion.

EXHIBIT I

ASSUMED PERCENTAGE INCREASES OVER PRIOR YEAR IN ANNUAL AVERAGE WAGES AND IN ANNUAL AVERAGE CPI

[In percent]

Calendar year	Increase in wages	Increase in CPI	Real Increase in wages
1974	7.9	9.1	1.2
1975	8.5	5.7	2.8
1976	8.0	4.5	3.5
1977	7.6	3.2	4.4
1978	5.5	3.0	2.5
1979	5.5	3.0	2.5
1980	5.5	3.0	2.5
1981-2045	5.0	3.0	2.0

119

EXHIBIT II

Projected total fertility rates

Year:	Average number of babies born per woman in her lifetime
1974.....	1. 938
1975.....	1. 949
1980.....	2. 040
1985.....	2. 095
1990.....	2. 104
1995.....	2. 102
2000.....	2. 100
2005.....	2. 100
2010-2045.....	2. 100

EXHIBIT III

Total fertility rates, United States, 1940-73

Year:	Total fertility rate	Year:	Total fertility rate
1940.....	2. 3	1957.....	3. 77
1941.....	2. 4	1958.....	3. 70
1942.....	2. 63	1959.....	3. 71
1943.....	2. 72	1960.....	3. 65
1944.....	2. 57	1961.....	3. 63
1945.....	2. 49	1962.....	3. 47
1946.....	2. 94	1963.....	3. 33
1947.....	3. 27	1964.....	3. 21
1948.....	3. 11	1965.....	2. 93
1949.....	3. 11	1966.....	2. 74
1950.....	3. 09	1967.....	2. 57
1951.....	3. 27	1968.....	2. 48
1952.....	3. 36	1969.....	2. 46
1953.....	3. 42	1970.....	2. 48
1954.....	3. 54	1971.....	¹ 2. 28
1955.....	3. 58	1972.....	¹ 2. 02
1956.....	3. 69	1973.....	¹ 1. 90

¹ Preliminary value.

EXHIBIT IV

AVERAGE WAGE AND SALARY EARNINGS: COMPOUND ANNUAL RATES OF GROWTH

[In percent]

		From												
	Average wages	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961	
To:														
1950	\$2,274.00													
1951	2,425.00	6.64												
1952	2,560.00	6.10	5.57											
1953	2,726.00	6.23	6.02	6.48										
1954	2,773.00	5.08	4.57	4.08	1.72									
1955	2,881.00	4.85	4.40	4.02	2.80	3.89								
1956	3,062.00	5.08	4.78	4.58	3.95	5.02	6.28							
1957	3,175.00	4.88	4.59	4.40	3.89	4.62	4.98	3.69						
1958	3,248.00	4.56	4.76	4.05	3.57	4.03	4.08	2.99	2.30					
1959	3,410.00	4.60	4.35	4.18	3.80	4.22	4.30	3.65	3.63	4.99				
1960	3,523.00	4.47	4.24	4.07	3.73	4.07	4.11	3.57	3.53	4.15	3.31			
1961	3,573.00	4.19	3.95	3.77	3.44	3.69	3.65	3.13	3.00	3.23	2.36	1.42		
1962	3,741.00	4.24	4.02	3.87	3.58	3.81	3.80	3.39	3.34	3.60	3.14	3.05	4.70	
1963	3,848.00	4.13	3.92	3.77	3.51	3.71	3.68	3.32	3.26	3.45	3.07	2.99	3.78	
1964	4,027.00	4.17	3.98	3.85	3.61	3.80	3.79	3.48	3.45	3.65	3.38	3.40	4.07	
1965	4,128.00	4.06	3.87	3.74	3.52	3.68	3.66	3.37	3.34	3.48	3.24	3.22	3.68	
1966	4,356.00	4.15	3.98	3.87	3.67	3.84	3.83	3.59	3.58	3.74	3.56	3.60	4.04	
1967	4,603.00	4.24	4.09	3.99	3.81	3.88	3.98	3.78	3.78	3.95	3.87	3.89	4.31	
1968	4,896.00	4.35	4.22	4.14	3.98	4.14	4.16	3.99	4.02	4.19	4.10	4.20	4.60	
1969	5,217.00	4.47	4.36	4.28	4.14	4.30	4.33	4.18	4.23	4.40	4.34	4.46	4.85	
1970	5,497.00	4.51	4.40	4.34	4.21	4.37	4.40	4.27	4.31	4.48	4.44	4.55	4.90	
1971	5,777.00	4.54	4.44	4.38	4.26	4.41	4.44	4.32	4.37	4.53	4.49	4.60	4.92	
1972	6,158.00	4.63	4.54	4.49	4.38	4.53	4.57	4.46	4.52	4.68	4.65	4.76	5.07	
1973	6,620.00	4.76	4.67	4.63	4.54	4.69	4.73	4.64	4.70	4.86	4.85	4.97	5.27	

	Average wages	From											
		1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973
To:													
1950	\$2,274.00												
1951	2,425.00												
1952	2,560.00												
1953	2,726.00												
1954	2,773.00												
1955	2,881.00												
1956	3,062.00												
1957	3,175.00												
1958	3,248.00												
1959	3,410.00												
1960	3,523.00												
1961	3,573.00												
1962	3,741.00												
1963	3,848.00	2.86											
1964	4,027.00	3.75	4.65										
1965	4,128.00	3.34	3.57	2.51									
1966	4,356.00	3.88	4.22	4.00	5.52								
1967	4,603.00	4.23	4.58	4.56	5.60	5.67							
1968	4,896.00	4.59	4.94	5.01	5.85	6.02	6.37						
1969	5,217.00	4.87	5.20	5.31	6.03	6.20	6.46	6.56					
1970	5,497.00	4.93	5.23	5.32	5.90	5.99	6.10	5.96	5.37				
1971	5,777.00	4.95	5.21	5.29	5.76	5.81	5.84	5.67	5.23	5.09			
1972	6,158.00	5.11	5.36	5.45	5.88	5.94	5.99	5.90	5.68	5.84	6.60		
1973	6,620.00	5.33	5.58	5.68	6.08	6.16	6.24	6.22	6.14	6.39	7.05	7.50	

121

EXHIBIT V

CPI: COMPOUND ANNUAL RATES OF GROWTH

[In percent]

		From											
	CPI (1967=100)	1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961
To:													
1950	-----	72.07											
1951	-----	77.82	7.98										
1952	-----	79.57	5.07	2.25									
1953	-----	80.20	3.63	1.52	.79								
1954	-----	80.48	2.80	1.13	.57	.35							
1955	-----	80.27	2.18	.78	.29	.04	-.26						
1956	-----	81.43	2.06	.91	.58	.51	.59	1.45					
1957	-----	84.26	2.26	1.33	1.15	1.24	1.54	2.46	3.49				
1958	-----	86.59	2.32	1.54	1.42	1.55	1.95	2.56	3.12	2.77			
1959	-----	87.27	2.15	1.44	1.33	1.42	1.63	2.11	2.34	1.77	.79		
1960	-----	88.65	2.09	1.46	1.36	1.44	1.62	2.01	2.15	1.71	1.18	1.58	
1961	-----	89.60	2.00	1.42	1.33	1.40	1.55	1.85	1.93	1.55	1.15	1.33	1.07
1962	-----	90.63	1.93	1.39	1.31	1.37	1.50	1.75	1.80	1.47	1.15	1.27	1.11
1963	-----	91.75	1.87	1.38	1.30	1.35	1.47	1.68	1.72	1.43	1.16	1.26	1.15
1964	-----	92.95	1.83	1.38	1.30	1.35	1.45	1.64	1.67	1.41	1.19	1.27	1.19
1965	-----	94.50	1.82	1.40	1.33	1.38	1.47	1.65	1.67	1.44	1.26	1.34	1.29
1966	-----	97.25	1.89	1.50	1.44	1.49	1.59	1.76	1.79	1.61	1.46	1.56	1.56
1967	-----	100.00	1.95	1.58	1.54	1.59	1.68	1.85	1.89	1.73	1.61	1.72	1.74
1968	-----	104.20	2.07	1.73	1.70	1.76	1.86	2.03	2.08	1.95	1.87	1.99	2.04
1969	-----	109.80	2.24	1.93	1.91	1.98	2.09	2.26	2.33	2.23	2.18	2.32	2.41
1970	-----	116.30	2.42	2.14	2.13	2.21	2.33	2.50	2.58	2.51	2.49	2.64	2.75
1971	-----	121.30	2.51	2.24	2.24	2.33	2.44	2.61	2.69	2.64	2.63	2.78	2.89
1972	-----	125.30	2.55	2.29	2.30	2.38	2.49	2.65	2.73	2.68	2.67	2.87	2.93
1973	-----	133.10	2.70	2.47	2.48	2.57	2.68	2.85	2.93	2.90	2.91	3.06	3.18

		From											
	CPI (1967=100)	1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973
To:													
1950	-----	72.07											
1951	-----	77.82											
1952	-----	79.57											
1953	-----	80.20											
1954	-----	80.48											
1955	-----	80.27											
1956	-----	81.43											
1957	-----	84.26											
1958	-----	86.59											
1959	-----	87.27											
1960	-----	88.65											
1961	-----	89.60											
1962	-----	90.63											
1963	-----	91.75	1.24										
1964	-----	92.95	1.27	1.31									
1965	-----	94.50	1.40	1.49	1.67								
1966	-----	97.25	1.78	1.96	2.29	2.91							
1967	-----	100.00	1.99	2.18	2.47	2.87	2.83						
1968	-----	104.20	2.35	2.58	2.80	3.31	3.51	4.20					
1969	-----	109.80	2.78	3.04	3.39	3.82	4.13	4.79	5.37				
1970	-----	116.30	3.17	3.45	3.81	4.24	4.57	5.16	5.65	5.92			
1971	-----	121.30	3.29	3.55	3.88	4.25	4.52	4.95	5.20	5.11	4.30		
1972	-----	125.30	3.29	3.52	3.80	4.11	4.31	4.61	4.72	4.50	3.80	3.30	
1973	-----	133.10	3.56	3.79	4.07	4.37	4.59	4.88	5.02	4.93	4.60	4.75	6.23

122

EXHIBIT VI

REAL AVERAGE WAGE AND SALARY EARNINGS: COMPOUND ANNUAL RATES OF GROWTH

[In percent]

		From											
Real wages		1950	1951	1952	1953	1954	1955	1956	1957	1958	1959	1960	1961
To:													
1950	3, 155. 77												
1951	3, 116. 17	-1. 24											
1952	3, 217. 29	. 98	3. 25										
1953	3, 399. 00	2. 51	4. 44	5. 65									
1954	3, 445. 58	2. 22	3. 41	3. 49	1. 37								
1955	3, 589. 14	2. 61	3. 60	3. 71	2. 76	4. 17							
1956	3, 760. 28	2. 97	3. 83	3. 98	3. 42	4. 47	4. 77						
1957	3, 768. 10	2. 57	3. 22	3. 21	2. 61	3. 93	2. 46	. 21					
1958	3, 751. 21	2. 19	2. 68	2. 59	1. 99	2. 15	1. 48	-. 12	-. 45				
1959	3, 907. 41	2. 40	2. 87	2. 82	2. 35	2. 55	2. 15	1. 29	1. 83	4. 17			
1960	3, 974. 05	2. 33	2. 74	2. 68	2. 26	2. 41	2. 06	1. 39	1. 79	2. 93	1. 71		
1961	3, 987. 72	2. 15	2. 50	2. 41	2. 02	2. 11	1. 77	1. 18	1. 43	2. 06	1. 02	. 34	
1962	4, 127. 77	2. 26	2. 58	2. 52	2. 18	2. 28	2. 02	1. 57	1. 84	2. 42	1. 85	1. 92	3. 51
1963	4, 194. 01	2. 21	2. 51	2. 44	2. 12	2. 21	1. 97	1. 57	1. 80	2. 26	1. 79	1. 81	2. 55
1964	4, 332. 44	2. 29	2. 57	2. 51	2. 23	2. 23	2. 11	1. 79	2. 01	2. 43	2. 09	2. 18	2. 80
1965	4, 368. 25	2. 19	2. 44	2. 38	2. 11	2. 10	1. 98	1. 68	1. 86	2. 20	1. 88	1. 91	2. 30
1966	4, 479. 18	2. 21	2. 45	2. 39	2. 15	2. 21	2. 03	1. 76	1. 94	2. 24	1. 97	2. 01	2. 35
1967	4, 503. 00	2. 25	2. 47	2. 42	2. 19	2. 25	2. 09	1. 86	2. 02	2. 30	2. 07	2. 12	2. 42
1968	4, 698. 66	2. 24	2. 45	2. 40	2. 18	2. 24	2. 09	1. 87	2. 03	2. 28	2. 07	2. 12	2. 37
1969	4, 751. 37	2. 18	2. 37	2. 32	2. 12	2. 17	2. 02	1. 82	1. 95	2. 17	1. 97	2. 00	2. 21
1970	4, 726. 57	2. 04	2. 22	2. 16	1. 96	2. 00	1. 85	1. 65	1. 76	1. 95	1. 75	1. 75	1. 91
1971	4, 762. 57	1. 98	2. 14	2. 09	1. 89	1. 92	1. 78	1. 59	1. 69	1. 85	1. 66	1. 66	1. 79
1972	4, 914. 60	2. 03	2. 19	2. 14	1. 96	1. 99	1. 87	1. 69	1. 79	1. 95	1. 78	1. 79	1. 92
1973	4, 973. 70	2. 00	2. 15	2. 10	1. 92	1. 95	1. 83	1. 66	1. 75	1. 90	1. 74	1. 74	1. 86

		From											
Real wages		1962	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972	1973
To:													
1950	3, 155. 27												
1951	3, 116. 17												
1952	3, 217. 29												
1953	3, 399. 00												
1954	3, 445. 58												
1955	3, 589. 14												
1956	3, 760. 28												
1957	3, 768. 10												
1958	3, 751. 01												
1959	3, 907. 41												
1960	3, 974. 05												
1961	3, 987. 72												
1962	4, 127. 77												
1963	4, 194. 01	1. 60											
1964	4, 332. 44	2. 45	3. 30										
1965	4, 368. 25	1. 91	2. 06	. 83									
1966	4, 479. 18	2. 06	2. 22	1. 68	2. 54								
1967	4, 603. 00	2. 20	2. 35	2. 04	2. 65	2. 76							
1968	4, 698. 66	2. 18	2. 30	2. 05	2. 46	2. 42	2. 08						
1969	4, 751. 37	2. 03	2. 10	1. 86	2. 12	1. 99	1. 60	1. 12					
1970	4, 726. 57	1. 71	1. 72	1. 46	1. 59	1. 35	. 89	. 30	-. 52				
1971	4, 762. 57	1. 60	1. 69	1. 36	1. 45	1. 73	. 86	. 45	. 12	. 76			
1972	4, 914. 60	1. 76	1. 78	1. 58	1. 70	1. 56	1. 32	1. 13	1. 13	1. 97	3. 19		
1973	4, 973. 70	1. 71	1. 72	1. 55	1. 64	1. 51	1. 30	1. 14	1. 15	1. 71	2. 19	1. 20	

STATEMENT OF ELIZABETH C. NORWOOD

As a member of the Subcommittee, I endorse the report of the Subcommittee on Finance of the Advisory Council on Social Security, dated February 3, 1975, with certain minor exceptions.

The style and rhetoric are outstanding representing many hours of thought and laborious work on the part of the Chairman. On the other hand, I would feel remiss if I did not indicate that in a few instances, the report gives a somewhat different impression of what actually transpired within the Subcommittee sessions to the best of my recollection.

tion and notes. Some paragraphs appear to be irrelevant and not germane to the subject then under discussion:

(1) On page 93, last paragraph, I recommend deletion of the entire paragraph and substitute in lieu thereof the third full paragraph, page 45, Chapter 7—Finance, beginning “The current cost method would be unacceptable . . .” etc. (even though speculative).

(2) On page 94, delete the fifth paragraph “The entire Social Security program . . .” since it appears to denote a conservative bias.

(3) On pages 97 and 98, rather than go into such detail on the shape of deficit and cause, would not a general statement on the difficulty of forecasting suffice? I do believe, however, that it is important to bring out that the deficit is small in the beginning and large at the end.

(4) On page 99 the fifth and sixth paragraphs, the number one economic problem is unemployment and all measures must be taken to overcome it, regardless of the need to support an estimated 3 percent level of inflation.

(5) On pages 99 and 100, delete the reasons given for the decline in productivity. Many reasons exist for the decline and it seems unnecessary that this reference be included in the report.

(6) On pages 114 and 115, delete Section D since it distorts the deliberations of the Subcommittee. (Section C is also not fully accurate, but is more accurate than D.) To the best of my recollection, a separate vote on a specific tax rate increase was never taken. Rather, the discussion centered around a shift of 1.0 percent of Part A Medicare financing to general revenues, to cover a 1.0 percent short-range deficit in the OASDI program. While there was some mention of OASDI tax rate increases taking place at the same time the Part A Medicare tax is decreased, I believe the Subcommittee should have voted on the specific changes.

Since these specific votes were not taken, the Subcommittee report should not imply that they were.

In this same connection, on page 115, the last paragraph, delete the clause “per the Subcommittee’s recommendation” since the Subcommittee did not make this recommendation.

(7) On page 116, last paragraph, there is no justification for speculating as to whether or not income taxes will have to be increased to fund Medicare. The government has other sources of revenues—income tax money is only one. Also, suggest deleting the sentence: “Some might even incur a higher total tax burden than under the present system.”—again, speculation.

(8) Referring to page 117, subparagraph B, and continuing on page 118, I cannot concur that a recommendation be included in this report to the effect that the retirement age be gradually increased beginning in 2005. It is premature to make such a recommendation for the 21st century.

Had financing not been the crucial consideration, I would have urged an even earlier retirement age than provided under the present system, especially in view of the current economic situation.

While these comments are directed specifically at the Report of the Subcommittee on Financing, they also can be applied in substance to Chapter 7 of the Council’s report.¹

¹ Mr. Arnold and Mr. Cleary concur with this statement as it applies to Chapter 7.

REPORT BY THE ACTUARIAL AND ECONOMIC CONSULTANTS TO THE SOCIAL SECURITY ADVISORY COUNCIL SUBCOMMITTEE ON FINANCING

Our review of the financing of the Social Security program was confined to a few key issues, because of the short period that was available.¹ This report summarizes our conclusions regarding those issues which we consider most important; as noted below, it is supplemented by a separate report on "decoupling."

1. METHOD OF FINANCING

The OASDI program is a national program requiring compulsory participation by the vast majority of employees, and presumably will continue to operate during all years in the future. These unique characteristics are the bases for our support of the conclusion that the current-cost method of financing the program provides sufficient assurance that funds will be available to pay benefits as they become due.

Under the current-cost method of financing, the amount of taxes to be collected each year is intended to be approximately equal to the benefits paid during that year.² The projected pattern of benefits which will be payable, under present law, results in the need for an increasing tax rate over the next 75 years. An increase in the tax rate is already legislated for the year 2011. In fact estimates which we consider reasonable indicate that the tax rates will have to be higher than those now specified in the law.

The purpose of the Trust Fund under current-cost financing is to reflect all financial transactions and to absorb temporary fluctuations in the relative level of income and expenditures. Thus, whatever "normal" (or target) level is established for the fund, it is to be expected that the fund will vary from that level as it absorbs those fluctuations. There is no definitive basis for establishing such a normal level,³ and the present level (approximately 70 percent of one year's outgo) is within the range of reasonable values. It is projected that the Trust Fund will decrease, in relation to outgo, over the next several years. Nevertheless, the Trust Fund should be adequate to fulfill its function, and any action to increase its level (relative to outgo) can be implemented over an extended period of time.

The requirements for future increases in the tax rate, and the relatively small size of the Trust Fund, do not conflict with the conclusion that the current-cost method of financing is actuarially sound for this social insurance program. Accumulation of a substantially larger Trust Fund, by raising taxes now, would not increase the actuarial adequacy of the program; however (as noted in Section 4 below) the economic and social consequences of alternative tax schedules, and resulting Trust Fund levels, are not fully understood and should be investigated further.

There has been a substantial number of articles in the public press which reflect the erroneous conclusion that the financing of the program is inadequate because there are not large (e.g., on the order of \$2 trillion) reserve funds. That conclusion is based on lack of

¹ In particular, we did very little analysis of the disability and medicare aspects of the program.

² There are also other factors—expenses, interest on investments, and the desired increase in the Trust Funds—which have relatively minor effect.

³ However, one of the consultants strongly believes that it should equal one year's benefits plus adminis-

recognition of the unique characteristics of this program; instead, the attempt is made to apply standards that are appropriate for an insurance company, private pension plan, or other arrangement that cannot anticipate indefinite continuation of its operations. In that type of operation, the liabilities that have accrued should, as an ultimate goal, be offset by investments; thus there is reliance on future income, and repayment of principal, that is expected from those investments. It should be particularly noted that U.S. Government Bonds, and hence reliance upon the future taxing power of the government, are generally considered the most secure form of investment with respect to assurance of timely payment of interest and principal.

Financing of the Social Security program relies directly upon the future taxing power of the U.S. The substitution of U.S. Government Bonds (or any other investment) would create a formal contractual obligation to provide that future income, but there is no reason to believe that under the current procedure, based on congressional intent, there is any less assurance that funds will be available to pay future benefits.

2. VARIABILITY OF BENEFITS AND COSTS

Under current law, benefits that will be provided to future retirees are related, in a complicated way, to increases in the Consumer Price Index (CPI) and to earnings. Thus two important relations are quite sensitive to the rate of change in the CPI, as well as to the rate of change in earnings levels. These relationships are:

(A) An individual payee's "replacement ratio," which is his initial benefit level divided by his immediately preceding earnings level.

(B) The aggregate benefit payments for any year as compared with that year's taxable payroll; that is the approximate tax rate appropriate for that year under the current-cost method of financing.

We have submitted a separate report describing a proposal to "decouple" initial benefit determinations from changes that have occurred in the CPI.⁴ Such initial benefit determinations would depend only on changes that have occurred in earnings levels.

The primary result of this decoupling is to make the system much less sensitive to changes in economic conditions. For all practical purposes, replacement ratios would become independent of the level of changes in earnings or CPI, and the tax rate appropriate for each year would be less affected by changes in earnings or CPI than under present law. A secondary result is that, using the assumptions of the 1974 Trustees Report, there is a decrease in the estimated long-range deficits (as indicated in Section 3, below).

3. ASSUMPTIONS AND ESTIMATES

We gave extensive consideration to the conclusion, in the 1974 Trustees Report for the OASDI program, that there is an "actuarial deficit"; that is, that future benefits will require more funds that will be produced by the tax schedule in the law.

⁴ CPI changes would continue to affect the adjustments of benefits after they have commenced.

Of course, when projections are made for 75 years into the future, and involve political, social, and economic forces—as well as natural forces such as mortality and fertility—it is not unlikely that actual experience may depart significantly from the assumed results. Nevertheless, we find the Trustees' conclusion is a reasonable indicator of future experience, subject to the following comments:

(A) The actuarial deficit will be significantly affected by future changes in the CPI, as well as by the difference between those changes and changes in earnings levels. It is very difficult to predict these effects, and our concurrence with the Trustees' assumptions⁵ is not unanimous. As noted in Section 2 above, we recommend that the program be "decoupled" in order to be less sensitive to those effects.

(B) Future fertility rates will have substantial effect on the program, and there is no reliable basis for predicting them. While a return to the replacement rate of 2.1 for total fertility seems reasonable (the present rate is less than that); two consultants expressed doubts about such an increase. In any event, there is a need to closely monitor fertility trends.

(C) While it seems reasonably certain that future benefits will require more financing than will be produced by the tax schedule in present law,⁶ it is important to recognize the yearly pattern of this "actuarial deficit." The situation is not adequately indicated by a single figure, such as the 2.98% "average" deficit for OASDI, even though the latter is a convenient description of the results. For example, data shown below at 15-year intervals provide significant additional information. In addition to showing the expected actuarial deficits for OASDI under current law, as estimated in the 1974 Trustees Report, there is also shown below an indication of the deficit if the program is decoupled as we suggest.⁷

ESTIMATED DEFICIT, AS PERCENTAGE OF TAXABLE PAYROLL

Year	Current law	Decoupled
1985.....	0.54	0.7
2000.....	1.41	1.5
2015.....	2.24	1.4
2030.....	5.70	3.9
2045.....	5.96	3.6
Average.....	2.98	2.1

While these figures do not clearly indicate all the annual variations estimated to occur over the next 75 years, they do give a much more useful indication of future results than is provided by the average annual deficit. Note that the 1974 Trustees Report shows current-cost estimates at 5-year intervals (e.g., Table 22), but does not explicitly compare them with the tax rates in the law. Thus the incidence of future deficits (or surpluses) is not evident. It would be helpful if such a comparison were explicitly set forth in future Trustee Reports.

⁵ The long-range assumptions are: 3 percent annual increase in CPI and 5 percent annual increase in earnings, so that the annual difference between CPI and earnings changes equal 2 percent.

⁶ This is likely to be true, even if the decoupling proposal referred to above is adopted.

⁷ Decoupling can be achieved in various ways, and the precise form selected will determine the costs but the figures give an indication of the probable result. One consultant believes that the deficit could be even further reduced by a satisfactory, but somewhat more complex, alternative decoupling formula.

Based on the figures shown for the decoupled program, a deficit will occur within the next few years, but it does not exceed 1 percent of payroll until almost 1995; projections over this short-term period are fairly reliable. The longer-term projections show substantially higher deficits (about 3.5 percent of payroll), but are also less reliable; actual deficits could be significantly more or less.

4. WIDER IMPLICATIONS

The most significant aspect of the Social Security cost projections is that they require an estimate to be made of certain conditions which will exist in the middle of the next century. Assumptions which we consider to be reasonable produce results so different from the current situation that attention should be directed toward the overall implications of those results, rather than toward their effect on the single issue of OASDI financing.

One of these assumptions is the future composition of the U.S. population. Aside from the difficulties inherent in projecting birth rates, it is probably more important to recognize that, if the population composition changes in accordance with these estimates, there are likely to be substantial effects on many of our social and economic arrangements. The 1972 Report of the Commission on Population Growth and the American Future dealt with many of these issues, but it limited its study to the period up to the year 2000; during that period OASDI financing is in fairly good balance. In order to put the issue of OASDI financing (and thus—of necessity—the issue of benefit levels, eligibility requirements, etc.) in proper perspective, it would be desirable to extend to the year 2050 the analysis of possible effects throughout our society of anticipated population changes.

Similarly, future changes in earnings rates and CPI can have substantial effects on OASDI (although, as noted, these would cause less problems if the program is decoupled). If (as some authorities have suggested) the annual increase in "real" earnings rates is less than the assumed 2 percent, the program, as defined by present law, would get substantially out of balance. However, it is likely that such a change in growth of real earnings (and presumably of productivity) would have substantial ramifications throughout our economic and social structure.

In any event, the OASDI program has become a major source of financing retirement, and it has effects on private pensions and individual savings. The implications of this on the nation's capital stock and the entire economy need further study and consideration.

Therefore, in the broader perspective of probable future developments, study should be given to questions such as: Will projected OASDI benefit payments become unduly burdensome on our economy? Will payrolls continue to be an acceptable basis for allocating the required taxes? Will the current-cost method of financing continue to be consistent with other economic and social goals?

Phillip Cagan, Professor of Economics, Columbia University; and Senior Staff Member, National Bureau of Economic Research.

Martin Feldstein, Professor of Economics, Harvard University.

Robert J. Myers, Professor of Actuarial Science, Temple University; former Chief Actuary, Social Security Administration.

Charles E. Trowbridge, Senior Vice President and Chief Actuary, The Bankers Life; former Chief Actuary, Social Security Administration.

Howard Young, Consulting Actuary; Special Consultant to the President, International Union, UAW.

DECOUPLING OF OASDI SYSTEM

Your consultants suggest to the Subcommittee, and hence to the entire Advisory Council, that the Council recommend the gradual phasing out of the "coupled" OASDI system now established by law, and the phasing in of a "decoupled" system, the outlines of which are the subject of this memo.

RATIONALE

We recognize that the rationale behind this suggestion is not immediately apparent. We do not claim that a decoupled system is *per se* superior to a coupled one. The case for the decoupled approach has been made in discussions we have had with the Subcommittee, but will be summarized here.

The goal of the decoupling suggestion is to improve the stability of the OASDI system under conditions of price and wage inflation.

The current system has provisions by which benefits in course of payment are adjusted to reflect increases in prices, as measured by the Consumer Price Index. The decoupling proposal would not change this feature.

Under the present system, potential benefits for those still at work are "coupled" with benefits for those already beneficiaries, and hence also reflect consumer price increases. Since the benefits of the OASDI system are wage-related, potential benefits also reflect increases in wages, but only in part. Certain technicalities prevent the full recognition of wage increases.

The difficulty that decoupling is intended to cure is that potential benefits do not increase directly with average wages (as one would expect in a wage-related system), but instead increase in a complicated way, mixing consumer price increases with a portion (something less than half) of wage increases. This mixed rate will be always greater than the CPI increase, but it may be either greater or less than the average wage increase. The important replacement ratio (the percentage that the old-age, survivor, or disability income bears to the worker's wages just prior to becoming a beneficiary) is therefore unstable. It rises when the gain in real wages is small, falls when it is large. This instability not only thwarts good pension design, but it makes future cost estimates depend heavily upon price and wage increase rates, over which the system can exercise no effective control.

A decoupled system can be designed to correct this instability, without negative effect on other aspects of the system. Potential benefits for those still working would fully reflect increase in average wages, but would be made independent of CPI changes. Replacement ratios, wherever they may be set initially, are therefore preserved, since potential benefits and wages increase together.

COST EFFECTS

If the gain in real wages happens to follow the 2 percent assumption chosen by the Social Security Administration for long range cost estimate purposes, then replacement ratios will tend to rise—not so much in the near future, but after 20 years or so. Increasing replacement ratios are responsible for a part of the deficit shown in the most recent Trustees report. The adoption of a decoupling proposal would therefore be helpful in reducing the deficit.

It is important to realize, however, that a decoupling proposal is *not necessarily* a cost-reducing one. If gains in real wages were to average 3 percent annually, replacement ratios under the coupled system would slowly fall. Under these circumstances a decoupled system would prevent replacement ratio deterioration, and hence be more costly than the present coupled system.

Your consultants recommend the decoupled system because of its improved stability under forces of inflation, not because it appears to reduce the actuarial deficit. The fact that decoupling would improve the actuarial balance (under assumptions which the consultants find reasonable) also commends it to us—but we would recommend it even if we thought that the effect would be in the opposite direction.

THE AVERAGE INDEXED MONTHLY WAGE

As a first step toward achieving our objectives, we suggest that benefits be based on an “average indexed monthly wage”.

We propose no change in the averaging periods, in the rules about dropout years, or any other feature of the AMW calculation, except that an indexing system will be applied to change the AMW to an AIMW (average indexed monthly wage).

The wage record of any past year is indexed by multiplying it by the ratio that average wages of the most recent calendar year bear to the average wages of the year being indexed. For this purpose, average wages for a calendar year are determined by the same method as is currently used for adjustment of the taxable earnings base and the exempt amounts under the retirement test.

In effect each year's wage record is being adjusted to current wage levels. Under conditions of continuously rising wage levels, the AIMW will always be higher than the AMW, with the difference depending upon how recent the record is. When the averaging period is long (as it is in retirement situations) the AIMW will be substantially greater than the AMW—but for short and recent wage records (as in young-age death or disability situations) the AIMW will only be slightly larger than the presently defined AMW.

The AIMW maintains for all past years the relative earnings of a worker in relation to the average earnings of all workers. The AMW does not do so, because it depends heavily on how many of the most recent years, and how few of much earlier years, are included in the average. The consultants therefore consider the AIMW superior to the AMW in achieving equity between generations of workers.

THE PRIMARY INSURANCE AMOUNT

We suggest that the primary insurance amount (PIA) on which all OASDI benefits are based be calculated by a simple two-term formula of the following form:

$$\text{PIA} = \$A + B\% \text{ of AIMW}$$

The $\$A$ would rise as average wages rise (in accordance with the same average wage index as used in calculation of the AIMW, which is also the index used under present law in adjusting the taxable earnings base). The B percent would remain level, but the AIMW would change each year with the average wage index. The PIA itself would therefore go up as fast as wages, and replacement ratios could be expected to remain constant over time.

The setting of the $\$A$ and B percent would determine replacement ratios under the new system. Unless there are good reasons to set replacement ratios either higher or lower than they are today, A and B would be set to reproduce, as closely as possible, the PIA's of those becoming beneficiaries in year y under the coupled system, where y is the effective year of change to the decoupled system. The fit can be quite close for all levels of income, though obviously few beneficiaries will be fit exactly, many having slightly greater benefits in year y than formerly, but some having smaller new-formula benefits. The new-formula benefits are likely to be the smaller when the AMW and the AIMW are close together, as when workers die or become disabled at the younger ages.

The attached illustration is intended to demonstrate that PIA's for those becoming beneficiaries in 1975 under the old system can be fit rather closely by the procedure suggested. For this illustration $A = \$85$ and $B = 28$ percent. If the change were delayed to 1976 or later some modification of the value of A and/or B would be needed to produce a satisfactory fit.

THE PHASING-IN PROCESS

The consultants have no intention of reducing benefits when the new formula produces a lower result than the old one. It is clearly important that the new beneficiary of year y actually receive the greater of the new-formula PIA and the old-system PIA. For those becoming beneficiaries after year y the same comparison is to be made, and the greater benefit granted; with the understanding, however, that the old-system benefit table will not be updated for CPI changes after year y . As time goes on, the new-formula result (dynamic with average wages) will be greater than the PIA from the old system (static at the year y level) for a larger and larger percentage of the new beneficiaries, and the old system will be slowly phased out. The young-age death and disability cases will likely be the last to be payable on the new formula.

THE TRANSITION PROBLEM AT RETIREMENT

There is an important technical advantage in the present coupled system in that problems of consistency between potential and actual benefits are neatly avoided. The PIA is essentially independent of the worker's choice as to when he retires, and the worker who retires in any

month gets the same benefit as the otherwise similar worker who retires one month later.

Under the decoupled system potential benefits are increasing with average wages, while benefits after retirement are increasing with the CPI. Details of the timing of the CPI increases, of the timing of increases in the \$A, and of the exact time period to which wage records are indexed must all be worked out to avoid inequities and to minimize incentives either to hasten or to postpone retirement.

The consultants are developing a set of procedures to best solve this technical problem. They have considered this matter in sufficient depth to conclude that a satisfactory solution exists. Recommendations as to the details will be furnished when needed.

SIDE EFFECTS

Although decoupling is proposed to improve the stability of the replacement ratios, and hence to avoid their drift either upward or downward as prices and wages change in relation to each other, the proposal will have effects on certain other internal relationships. The consultants consider these effects as improving the general level of equity between various members of the system; but others might have different views. The most important of these side effects are the following:

1. The present system provides higher replacement ratios in young-age death and disability situations than for workers who work to retirement, or who die or become disabled later in their careers. This feature of the present law was not intended, and has been the target of considerable criticism, particularly since the young worker has contributed to the system for such a short period of time.

The wage indexing feature of the new system makes unimportant the differences in how recent the wage record may be; and in effect equalizes the replacement ratios between young and old. The young-age advantage persists for quite some period of time since it phases out very slowly; but it will eventually disappear.⁸

2. The present system treats very differently the worker covered under the system for only a portion of his career, depending on whether the covered years were at the young adult ages or at ages close to retirement. The worker retiring today with 10 years of covered service ending 30 years ago has a much smaller AMW, and hence a smaller PIA, than the otherwise similar worker who was in covered employment in the 10 years just ended.

The wage indexing feature of the new system removes these differences, by bringing benefits for early-career workers (quite often women who worked prior to marriage) up to the level of short-service-in-late-career workers.

3. It is our understanding that the Council has voted to recommend that the \$93.80 minimum PIA not be increased, even though other benefits go up with the CPI. Such an effect would take place automatically under this proposal, as soon as the new

⁸ Two of the consultants suggest that there are arguments for higher replacement ratios in death or disability situations, and recommend that such ratios be determined separately, rather than using the formula applicable to old-age benefits.

system became effective, because the old-system benefit table (which carries the minimum PIA) would then become static. It should be pointed out, however, that the \$A in the proposed PIA formula becomes a new form of a minimum PIA, gradually replacing the old. Moreover, the \$A is indexed to average wages, and will rise over time. Windfall benefits for those with very short covered service can not be eliminated by the decoupling procedure, unless the \$A is somehow reduced for short covered service. The lengthening of the required quarters of coverage for the fully insured status will be of some help in this regard.

SIMPLIFICATION

The replacement of the AMW by the AIMW perhaps leads to some element of complication in an already extremely complicated system. That the wage indexing principle is already employed in the adjustment of the taxable earnings base (and the exempt amounts under the retirement test) makes the public understanding easier.

The replacement of the extremely complicated formula underlying the benefit table used in the current system by the very simple two-term PIA formula proposed is an important step toward ease of explanation. The important replacement ratio, for example, is $B + A/AMW$, essentially independent of everything except where the worker has been, relative to others, in the wage distribution.

CONCLUSION

The consultants recommend the decoupled approach here outlined without reservation. We recognize that this proposal is not completely worked out in all detail, and that its structure is somewhat foreign to that of the extremely complicated system we live with today. We trust that the Council can look beyond the form and to the substance of these proposals. We believe it will find them sound.

ILLUSTRATION OF FIT—1975 AS YEAR WHEN NEW SYSTEM IS FIRST EFFECTIVE. FOR PERSONS WITH EARNINGS HISTORY OF SAME STEEPNESS AS AVERAGE WAGE¹

Final (1974) pay	Old system		Proposed formula	
	AMW	PIA	AIMW	PIA ³
Male worker retiring at age 65 in 1975: ²				
\$200.....	\$127	\$139	\$200	\$141
\$400.....	254	196	400	197
\$600.....	381	251	600	253
\$800.....	508	303	800	309
\$1,100 ⁴	542	316	837	319
Worker born in 1939 ⁵ —dying or becoming disabled in 1975:				
\$200.....	153	151	200	141
\$400.....	306	218	400	197
\$600.....	459	282	600	253
\$800.....	612	349	800	309
\$1,100 ⁴	685	376	883	332

¹ Where earnings history is steeper than average wages, PIA under old system more likely to be the larger. Where earnings history is flatter than average wages, proposed formula more likely to produce greater PIA.

² For females reaching age 65 in 1975, old system produces slightly higher results than males, because of shorter averaging period. Proposed formula treats males and females alike, because wage indexing makes difference in averaging period unimportant. Averaging period pulled together, in either system, for age 65 retirements in 1978 or later.

³ PIA formula \$85 plus 28 percent of AIMW. A slightly modified formula would be required if first effective date of new system was to be 1976 or later.

⁴ Maximum taxable earnings case. AMW, AIMW, and PIA all reflect history of taxable earnings base—rather than earnings history of worker.

⁵ Lower result under proposed formula less noticeable for those born before 1939—more so for those born later.

APPENDIX B

REPORT OF THE SUBCOMMITTEE ON THE TREATMENT OF MEN AND
WOMEN UNDER SOCIAL SECURITY (WITH RESPECT TO SEX AND
MARITAL STATUS), ADVISORY COUNCIL ON SOCIAL SECURITY

(133)

CONTENTS

	Page
Introduction.....	137
Scope of study.....	137
Socioeconomic changes.....	138
Other recent changes.....	142
Recent court cases and the proposed Equal Rights Amendment to the Constitution.....	142
Findings and recommendations.....	144
Recommendations concerning the social security provisions of the law that are different for men and women.....	144
Recommendation concerning the computation of benefit eligibility and benefit amounts, which is different for men and women born prior to 1913, but is the same for those born in 1913 or later.....	146
Recommendations concerning social security provisions of the law that are the same for men and women.....	147
General recommendation concerning all social security provisions of the law.....	148
Other major findings.....	148
Conclusion.....	149
Appendix—Summary list of recommendations.....	149

REPORT OF THE SUBCOMMITTEE ON THE TREATMENT OF MEN AND WOMEN UNDER SOCIAL SECURITY (WITH RESPECT TO SEX AND MARITAL STATUS), ADVISORY COUNCIL ON SOCIAL SECURITY

INTRODUCTION

The Subcommittee on the Treatment of Men and Women under Social Security (with respect to sex and marital status) was appointed by the Chairman of the Advisory Council on Social Security, W. Allen Wallis, during the Council's first meeting, on May 3, 1974, to consider differences in social security benefits and costs that are related to sex and marital status.

The members of the Subcommittee are Edward J. Cleary, Secretary-Treasurer, Building and Construction Trades Council of Greater New York, AFL-CIO; John J. Scanlon, Executive Vice President and Chief Financial Officer (Retired), American Telephone and Telegraph Company; and Rita Ricardo Campbell, Senior Fellow, Hoover Institution, Stanford University, Subcommittee chairman. During its deliberations the Subcommittee had the benefit of the capable assistance of Mr. Scanlon's associate, Therese F. Pick, Personnel Director-Employee Benefits, American Telephone and Telegraph Company.

The first meeting of the Subcommittee was held in Baltimore on May 24. Subsequent meetings were held in Washington, D.C., on June 30, in Chicago on August 4, and in Washington on September 21, November 3, and December 7 and 8, 1974, and January 18, 1975. All Subcommittee meetings were open to the public and notices of the meetings were published in the *Federal Register*.

The Subcommittee appreciates the competent and efficient technical advice and assistance it received from the staff of the Social Security Administration in carrying out its work. James E. Crum of the Social Security Administration's Office of Program Evaluation and Planning served as Executive Secretary of the Subcommittee.

SCOPE OF STUDY

During its deliberations the Subcommittee considered the following matters:

1. Social security provisions of the law that are different for men and women, including:

a. Different dependency requirements for spouses' and surviving spouses' benefits for men and women;

b. Provisions for a secondary benefit for categories of women (aged divorced wife or aged or disabled divorced widow, and mother with entitled child in her care) and not for the comparable categories of men.

c. Differences in computation of benefit eligibility and benefit amounts based on a man's earnings, as compared with a woman's, for those men who reached age 62 (or died after reaching age 62)

during 1954-74. (There are no differences for workers reaching age 62 after 1974.)

2. Inequities in benefits as related to taxes paid that exist between single workers and married workers.

3. Inequities in benefits as related to taxes paid by married women who work and married women who do not work and/or have not worked in covered employment.

4. The treatment under social security of married persons who do not work outside the home, and the pros and cons of permitting them to receive benefits on the basis of "imputed income" for work done in and around the home for which they are not paid wages.

5. The different effects of social security provisions that are the same for working men and working women who are permanently attached to the labor force but, because of the nature of the traditional jobs held by women and/or the typical life cycle of work among women, affect women differently than men—for example, the special minimum benefit.

It was early agreed that the complex issues to be considered by the Subcommittee in respect to treatment of men and women, married and single, under social security are intertwined and interdependent. It was also recognized that any package of recommendations might prove costly. The Subcommittee, therefore, agreed that all decisions reached during the course of its deliberations would be tentative decisions until finally approved for submission to the Council. Thus tentative decisions reached during the course of the Subcommittee's deliberations were subject to continuing review and revision throughout its deliberations.

Socioeconomic changes

The Subcommittee discussed in considerable depth the socioeconomic changes that have taken place since the enactment of the original Social Security Act, in 1935, which provided only a primary benefit upon retirement for a worker based on cumulative earnings and, for survivors, a lump-sum benefit less any benefits received by the worker. In 1939, the Act was amended to add secondary benefits for dependents—wives, widows, and children—of workers. The 1939 amendments changed the system from one of taxes and benefits each on an individual worker basis to one with taxes on an individual basis and benefits on a family basis and assumed in general that married women as well as children were dependent on the male head of the household.

Among the socioeconomic changes discussed and documented were the following:

A trend away from early marriages started some 15 years ago, and a concomitant, almost continuous decline in birth rates from 23.7 births per 1,000 population in 1960, to 18.2 in 1970 and to only 14.8 for the 12 months ending September 1974.¹ Although birth rates per 1,000 population were also low in 1930, 21.3, and in 1940, 19.4, they were still higher than currently. Moreover, since then today's newer methods of birth control, changes in social values, and recent great improvement in the infant mortality rate (at 17.1 per 1,000 live births for January-June 1974, as compared to 26.0

¹ U.S. Department of Health, Education, and Welfare, Public Health Service; 1960: *Vital Statistics of the United States 1960*, Volume 1—Section 1, p. 1-1; 1970 and 1974: *Monthly Vital Statistics Report*, Volume 19, No. 13, p. 1, and Volume 23, No. 9, p. 1.

per 1,000 in 1960, for example), all point to a probable continuation of a relatively low level of number of births.

Data from the annual survey of the work experience of the population 16 years old and older conducted in March 1974 by the Bureau of the Census for the Bureau of Labor Statistics show that in 1973, 54 percent of all women had worked at some time during the year, over two-thirds of them at full-time jobs. Among the regular part-time women workers, a group which has been increasing steadily over the past few years, 6 million worked 40 or more weeks during 1973 while 7 million worked less than this amount.² Today in all industrialized societies, the greater the percentage of women working, the lower the birth rate.

Smaller families have reduced the demands on women or on other family members to perform domestic duties within the home. In addition, especially in the United States, the increasing level and use of technology in the home—automatic washing machines and dryers, self-defrosting refrigerators, permanent-press clothing, readily available partially prepared foods, and their purchase as the family income rises when more than one person in the family works—have also greatly reduced the domestic workload of married women, with or without children. Concomitantly, the service sector of the economy has greatly expanded, offering the types of jobs which women have traditionally filled. Labor force data, which pick up fewer occasional or intermittent workers, show that while in 1920, 23 percent of all women 14 years and over were in the labor force, and only 25 percent in 1940, just a few years after the passage of the Act and one year after its important 1939 amendments, the proportion has increased to 34 percent of women 16 years and over in 1950, 38 percent in 1960, 43 percent in 1970, and 45 percent in 1973.³

Since the initiation of the Social Security Act, there has been a revolution in the structure of the family. Married couples with only the husband working no longer comprise the majority of families. In March 1974 there were 36.4 million husband and wife families in which the husband was age 23 to 64. Of these 36.4 million families, 18.5 million, or 51 percent, were families in which both the husband and the wife worked in 1973.⁴ There also has been a great increase in numbers of nonmarried individuals who are the heads of families, including women (divorced, separated, deserted, or widowed) who often are in the lowest-paying occupations.

In March 1973, 15.4 million women were heads of households; 23 percent of all the households in the United States were headed by women. Of these women, 4.3 million had children under 18 years of age and 2.8 million had relatives other than husband or child living with them ("husband" if present would be the "head of household" in Census data) and 8.2 million women lived alone.⁵

Another indication of the changing family structure is the increasing divorce rate; by 1970, 10 percent of all males and 12 percent of all

² U.S. Department of Labor, Bureau of Labor Statistics, *Summary, Special Labor Force Report*, "Work Experience of the Population in 1973," September 1974, p. 3.

³ 1920 through 1970, *Economic Report of the President*, January 1973, Table 21, p. 91; 1973, U.S. Department of Labor, Bureau of Labor Statistics, *Special Labor Force Report* 163, 1974, p. A-6.

⁴ U.S. Department of Commerce, Bureau of the Census, *Current Population Reports*, Series P-60, No. 97, computed from the table on p. 155.

⁵ U.S. Department of Commerce, Bureau of the Census, *Current Population Reports*, Series P-20, No. 258, p. 86.

females over 14 years of age had been divorced at least once. Increasingly, one-parent family units occur for a reason other than the death of the husband or wife.

Although the Subcommittee has not ventured to estimate the anticipated future trends of these socioeconomic changes, it recognizes that the social security system was not designed to handle such drastic family restructuring. A major concept on which the system as amended through the years is based is that it is in society's interest to replace earnings lost by retirement, disability, or death.

About 83 percent of wives who became entitled to a primary benefit in the last half of 1969 based on their own earnings and whose husbands were age 65 or over or were receiving retirement benefits did not receive any supplemental secondary benefit.⁶ This percentage is expected to increase. By 1970, 68 percent of women 45-49 years of age already had enough quarters of covered work to be insured for their own primary benefit.⁶ Labor force data indicate that this percentage is also increasing. At the end of 1974, about 2.6 million aged wives of retired workers on the benefit rolls—about 58 percent of all such wives on the benefit rolls—were receiving only a secondary benefit. It is expected that this percentage will decline gradually over the next 45 years or so, to between 30 and 35 percent in 2020 and thereafter, as the current beneficiaries become widows or die and a larger percentage of newly entitled wives qualify for their own primary benefit.

That an increasing proportion of aged wives of retired workers receives either a primary benefit or a primary plus some part of a secondary benefit indicates the effect of women's increasing participation in the labor force on the social security system. Currently about 1.9 million aged wives of retired workers on the benefit rolls—about 42 percent of all such wives now on the rolls—are getting primary benefits based on their own earnings.

As noted, the OASDI tax is on an individual's earnings and in the case of a married worker the benefits to replace earnings may include an additional amount on the basis of presumed need of other members of the family. The present provisions for spouse's and surviving spouse's benefits for a nonworking spouse mean that two-earner families may be treated disadvantageously as compared with one-earner families, although two-earner families are in the majority and have geared their style of living to the earnings of two people.

If the earnings of one of the two earners in a family are not high enough to result in a benefit equal to 50 percent of the other earner's benefit, the family will get no more in benefits than they would have gotten had the lower paid of the two not worked and paid social security taxes. Similarly, when the higher paid worker dies, the surviving spouse may get no more in benefits than he or she would have gotten without having worked and paid taxes.

The concept of replacement of earnings of both family workers should be considered as compared to that of the current law, which in some cases (1) provides no more in benefits to two-worker (husband and wife) families than the amount of benefits based only on the earnings of the higher paid family worker plus secondary benefits based on this worker's earnings and, (2) permits the anomaly that a one-earner

⁶ U.S. Department of Health, Education, and Welfare, Social Security Administration, Office of Research and Statistics, *Preliminary Findings from the Survey of New Beneficiaries*, Report No. 9, "Women Newly Entitled to Retired-Worker Benefits," by Virginia Reno, April 1973, pp. 4-5.

family may receive greater social security benefits (primary and secondary) than a two-earner family of equal size earning the same amount and paying the same OASDI taxes. It is the two-worker, husband and wife, family with relatively lower wages who falls within this inequitable category. For example, assume that a husband has average annual earnings under social security of \$4,000, and his wife has average annual earnings under social security of \$4,000, and they both reach age 65 and retire in early 1975. The monthly retirement benefit payable to the man is \$228.50, and the monthly benefit payable to his wife is \$228.50, for a total monthly retirement benefit for this couple of \$457.00. If only one worker in a family had earned the sum of the above couple's earnings, and had average annual earnings of \$8,000, the monthly primary benefit payable to that worker upon retirement at age 65 in 1975 would be \$316.30, and one-half of that primary for the nonworking spouse would be \$158.15, rounded to \$158.20 under the social security law, totaling \$474.50 a month for this couple. Thus, the benefits for the one-worker family would amount to \$210.00 more for a year than the benefits for the two-worker family.

For another example, assume that in each year since the social security program began a husband earned 60 percent of the maximum taxable base in effect in the year, and his wife 40 percent of the base, and they both reach age 65 and retire in early 1975. The monthly retirement benefit payable to the man is \$226.50, and the monthly benefit payable to his wife is \$179.60, for a total monthly retirement benefit for this couple of \$406.10. If over the same period of time only one worker in a family had earned the sum of the above couple's earnings or the maximum taxable base in effect in each year, the monthly primary benefit payable to that worker upon retirement at age 65 in 1975 would be \$316.30, and one-half of that primary for the nonworking spouse would be \$158.15, rounded to \$158.20 under the social security law, totaling \$474.50 a month for this couple. Thus, the benefits for the one-worker family would amount to \$820.80 more for a year than the benefits for the two-worker family.

Some increasing participation of women in the labor force was anticipated in part of the arguments used to support provision of secondary benefits in 1939. The Committee on Ways and Means of the House of Representatives, and the Committee on Finance of the Senate, stated in their reports on the 1939 amendments:

"Because more wives, in the long run, will build up wage credits on their own account, as a result of their own employment, these supplementary allowances will add but little to the ultimate cost of the system."⁷

These predictions were made many years before additional amendments were passed which liberalized secondary benefits as, for example, by providing the surviving aged widow with 100 percent of her husband's primary benefit. The secondary benefits being paid at the end of 1974 to the 2.6 million retired workers' aged wives who were getting only a secondary benefit were being paid at an annual rate of about \$3.2 billion, and to the 3.8 million aged or disabled widows getting only a secondary benefit at an annual rate of about \$8.0 billion.

⁷ U.S., Congress, House of Representatives, Committee on Ways and Means, *Social Security Act Amendments of 1939*, 76th Congress, 1st Session, 1939, House Report No. 728 to accompany H. R. 6635, p. 11; and U.S., Congress, Senate, Committee on Finance, *Social Security Act Amendments of 1939*, 76th Congress, 1st Session, 1939, Senate Report No. 734 to accompany H. R. 6635, p. 11.

Other recent changes

The Subcommittee also reviewed recent legislation which might affect its recommendations, as for example the income tax law revision of 1969, which, over a wide range of income brackets, gives a working man and woman who earn similar amounts an economic incentive to remain single or become divorced even though they might otherwise marry or remain married.⁸

In addition, the Subcommittee also took into consideration the new program of supplemental security income, which began in January 1974 and sets a minimum floor of income, financed from general revenues, for needy aged, blind, and disabled people, of \$140 monthly for an individual and \$210 monthly for husband and wife, increased to \$146 and \$219, respectively, as of July 1974.

Recent court cases and the proposed Equal Rights Amendment to the Constitution

The Subcommittee reviewed several court cases where discrimination by sex under the Social Security Act is an issue and additionally an 8-to-1 Supreme Court decision which held in violation of the due process clause of the Fifth Amendment a Federal statute which provided, solely for administrative convenience, that spouses of male members of the uniformed services are dependents for purposes of obtaining increased quarters allowances and medical and dental benefits but that spouses of female members are not dependents unless they are in fact dependent for over one-half of their support. [*Frontiero v. Richardson*, 411 U.S. 677 (1973)]. Only four members of the Court agreed that different treatment by sex was "inherently suspect." Three of the other four justices who voted, on other grounds, that the law was discriminatory, indicated that they did not want to "preempt by judicial action a major political decision" pending before the States—that is, the proposed Equal Rights Amendment. The Court found that classification and different treatment "solely for the purpose of achieving administrative convenience . . . involves . . . arbitrary legislative choice forbidden by the" Constitution. The Supreme Court noted that "there is substantial evidence that, if put to the test, many of the wives of male members would fail to qualify for benefits," and further that "The Constitution recognizes higher values than speed and efficiency."

District court cases were also discussed which are concerned with the differences in the social security law with respect to secondary benefits for males as compared with females based on their spouse's primary benefit under OASDI. One example is the U.S. District Court of New Jersey's Order of January 28, 1974 (Civil Action No. 268-73) in favor of Stephen Wiesenfeld [367 F. Supp. 981 (1973)], which held that section 202(g) of the Social Security Act unconstitutionally discriminates between men and women in that it provides mother's benefits for certain widows and surviving divorced mothers of deceased male wage earners, but does not provide "father's" benefits for similarly situated men. (The plaintiff's motion for the matter to proceed as a class action was denied.) The decision was appealed to the Supreme Court, June 18, 1974, and the Court has agreed to hear the case.

⁸ See George Cooper, "Working Wives and the Tax Law," in *Rutgers Law Review*, Fall 1970, p. 67ff.

A recent Florida Supreme Court decision (273 So. 2d 72; argued February 25, 26, 1974), which has been upheld by the Supreme Court, April 24, 1974, declares constitutional a Florida law which denies a widower an annual \$500 property tax exemption which is available to widows in Florida. The Court said the challenged State tax law was "reasonably designed to further the State policy of cushioning the financial impact of spousal loss upon the sex for whom that loss imposes a disproportionately heavy burden." [*Kahn v. Shevin*, 94 S. Ct. 1734, p. 1735 (1974)]. Two justices dissented, stating in part that "While doubtless some widowers are in financial need, no one suggests that such need results from sex discrimination as in the case of widows." (At pp. 1739-1740.) They noted that the State could narrow the class of widow beneficiaries to those widows actually in need and exclude those of "substantial economic means" and suggested that the State of Florida redraft the statute. Additionally, one justice in a separate dissent, elaborated further, "It seems to me that the State in this case is merely conferring an economic benefit in the form of a tax exemption and has not adequately explained why women should be treated differently than men." (At p. 1740.)

In another area of concern re discrimination by sex under social security a 2-to-1 majority opinion of April 19, 1974, by the U.S. District Court, Northern District of Illinois, Eastern Division, dismissed the complaint of the plaintiff, Michael V. Polelle, that social security [42 U.S.C. Code Sec. 415(b)(3)] discriminates by sex in favor of females as compared to males by its use of additional months up to 36 months or three years as part of the divisor in computation of average monthly earnings for males, but not for females, thus generally providing on identical earnings records lower benefits for a male than a female the same age. The Government successfully defended this distinction, which was phased out and does not exist for men who reach age 62 on or after January 1, 1975, on grounds, much simplified, as follows: that actual average earnings of females are so much lower than those of males that the different computation was partially to offset this differential, which is alleged to be at least in part because of sex discrimination prior to the Equal Pay Act and other Federal legislation and related, affirmative action programs. This case has not been appealed. As mentioned above, this difference in computation of benefits phased out under existing law as of January 1, 1975, when the method of computing benefits for workers who reach age 62 on or after that date became the same regardless of sex.

The Subcommittee has found that the courts are currently being asked in a number of cases to rule on whether various social security provisions of the law that are different for men and women are constitutional under the due process clause of the Fifth Amendment. The Supreme Court has not as yet ruled on the constitutionality of any provision of the social security law that is different for men and women. One case (*Wiesenfeld v. Secretary of Health, Education, and Welfare*) involving this question is currently before the Supreme Court.

Some of the recent Supreme Court decisions in sex discrimination cases *not* involving social security may give an indication of how the Court might react when it discusses whether those social security provisions of the law that are different for men and women are constitutional under the due process clause of the Fifth Amendment.

However, the issues involved in the nonsocial security cases are complex, and the factual situations and statutes under consideration in them differ in certain important respects from the social security provisions which are the subject of pending litigation. Accordingly, it is impossible to predict with certainty the outcome of the current social security litigation.

If the Supreme Court should find that one of the social security provisions of the law that are different for men and women is unconstitutional under the due process clause of the Fifth Amendment, the constitutionality of the other provisions that are different would be seriously questioned unless the legislative justification for the differing treatment in the remaining provisions is distinguishable from the justification or basis for the provision found to be unconstitutional. Under the due process clause, not *all* discrimination, but only that which is "invidious," has been held to be unconstitutional by the courts. Discrimination would be "invidious" if the statute compelling such treatment did not meet the appropriate constitutional test, that is, the "rational basis" test (whether the legislative classification bears a rational relationship to a legitimate government interest) or the "compelling interest" test (whether there is a countervailing compelling government interest against a finding that a provision is unconstitutional). Such tests look to the legislative justification for the discriminatory treatment in order to determine whether the treatment is constitutional. Thus, in the present state of the law, it is not possible to conclude that every statute which treats one sex more advantageously than the other is unconstitutional.

The fact that 34 States have ratified the proposed Equal Rights Amendment to the Constitution, which, if adopted, would provide that "Equality of rights under the law shall not be denied or abridged by the United States or by any State on account of sex," and only four additional States (six if rescinding of ratification is constitutional) have to ratify the proposed amendment in order to make it the law of the land, has been of paramount interest. If the proposed amendment is ratified by the required number (38) of States, it would on its effective date become the preeminent constitutional authority for sex discrimination issues, and prior Supreme Court opinions based on the due process clause of the Fifth Amendment would almost certainly be reconsidered by the Court in its deliberations on cases subsequently before it in light of the Equal Rights Amendment. Adoption of the proposed Equal Rights Amendment would raise serious doubts as to the constitutionality of any provision in the Social Security Act which is different for men and women.

FINDINGS AND RECOMMENDATIONS

As a result of its deliberations the Subcommittee has reached the following conclusions.

Recommendations concerning the social security provisions of the law that are different for men and women

The Subcommittee recommends that, in general, the social security provisions of the law that are different for men and women be made the same for both in the future.

The Subcommittee considered various alternative approaches to make the provisions of the law that are different for men and

women the same for both. The Subcommittee found that each approach has both advantages and disadvantages and that the selection of one approach over the others involves weighing the advantages and disadvantages of each approach against the others and making a value judgment as to which is the best approach. The Subcommittee believes that this decision is one the Council as a whole should make. Accordingly, after initially endorsing the first of the options discussed below, the Subcommittee upon reconsideration decided to present to the Council, without recommendation, the following three options for its consideration.

1. Eliminate the one-half support requirement in present law for men for entitlement to husband's and widower's benefits. (There is no such requirement in the law for women for entitlement to wife's and widow's benefits.) Provide spouses' (wife's and husband's) and surviving spouses' (widow's and widower's) secondary benefits under social security under the same implied test of dependency in present law for entitlement to secondary benefits by wives—that is, on the basis of “presumed need.” If the spouse (or surviving spouse) is not eligible for a primary social security benefit as a worker, or is eligible for one that does not equal or exceed the secondary benefit, the spouse would be “presumed dependent” and eligible for a secondary benefit. The amount of the secondary benefit would be equal to the difference between it and the primary benefit (if any). A person precluded by his or her primary social security benefit from becoming entitled to a spouse's or surviving spouse's benefit under present law would continue to be ineligible for such a benefit.

Provide benefits for a father who has in his care a child (entitled to child's insurance benefits) of his retired or disabled wife or deceased wife or former wife, and for an aged divorced husband of a worker entitled to old-age or disability insurance benefits, or an aged or disabled divorced widower of a deceased insured worker, on the same basis as benefits are provided for women in like circumstances.

A major advantage to this approach is that it would be the least complex and easiest to administer. A major disadvantage is that many of the men who would get dependent's or dependent survivor's benefits under this approach that they cannot get under present law would be men who had worked in noncovered employment, such as Federal civilian employment and certain State and local employment, and who were not financially dependent on their wives. Another major disadvantage is that this is the most expensive approach. It would increase the long-range cost of the social security cash benefits program by an estimated 0.11 percent of taxable payroll. Immediate universal coverage and, until fully effective, an offset for secondary beneficiaries who work in noncovered employment would help to overcome these disadvantages.

2. Retain the one-half-support requirement in the present law for men for entitlement to husband's and widower's benefits, and make mandatory the same one-half-support requirement for women, including divorced women, for entitlement to wife's, widow's, or mother's benefits in the future.

Provide benefits for fathers and for divorced men on the same basis as for women in like circumstances, including on the basis of meeting a one-half-support requirement.

The major advantages to this approach are that dependent's and dependent survivor's benefits would not be provided for nondependent men, or women, and the long-range cost of the social security cash benefits program would be decreased—not increased—by an estimated 0.17 percent of taxable payroll. However, this approach would increase the administrative complexity of the social security program. Dependent men and women would still be able to get a dependent's or dependent survivor's benefit, but dependent women would have to prove their dependency on the husband in order to get the same benefits they would get under present law without proving dependency.

3. Gradually phase out all secondary benefits except dependent children's benefits, or, alternatively, phase out all spouses' secondary retirement benefits keeping survivors' benefits. One way to do this might be to reduce gradually over time for new entitlements the proportion of the worker's primary benefit that is provided for dependents. For example, after 6 years the present 50-percent wife's or husband's benefit might drop to 40 percent, then to 30 percent after another 6 years, to 20 percent 6 years later, and so forth, until the secondary retirement benefits are completely eliminated.

If it were to be recommended now that only spouses' (age 62 or older) secondary benefits should be phased out, at some future time other Councils who might have more time to study the broader proposal and its interrelations with the demographic impact of lower birth rates and increasing labor force participation rates of women might recommend that other secondary benefits (except children's) could be reduced in a similar fashion.

A gradual phasing out of secondary benefits would avoid disadvantaging those coming on the benefit rolls in the next several years who would not have much opportunity to provide a replacement for a benefit they may have been anticipating and planning their retirement around. For those becoming entitled to benefits later, the decrease in the benefits would be greater as the period of time available to them to replace the benefits lengthened.

This approach would eliminate most of the existing differences in treatment of singles and marrieds, for which this Subcommittee found no acceptable alternative, and would also eliminate the differences in treatment of the married woman who works and the married woman who does not work.

The approach would also decrease the cost of the social security cash benefits program. The amount of the decrease would depend on how gradual the phaseout was and the length of time over which it was accomplished and whether surviving spouses' benefits were retained or not. The estimated long-range saving from phasing out spouses' (age 62 and over) secondary benefits as described above is 0.39 percent of taxable payroll.

Recommendation concerning the computation of benefit eligibility and benefit amounts, which is different for men and women born prior to 1913, but is the same for those born in 1913 or later

The Subcommittee does not recommend any change in the computation of benefit eligibility and benefit amounts retroactively or retrospectively with respect to benefits based on the earnings of workers who reach age 62 before January 1, 1975, and whose benefit may reflect a difference by sex in the computation of the benefit. To do so

would be very costly, estimated on a retrospective basis at about \$1.8 billion a year for the next several years and still as much as about \$1.5 billion a year some 10 years from now. (The law is the same for workers reaching age 62 after 1974.)

Recommendations concerning social security provisions of the law that are the same for men and women

1. The retirement benefits that are payable under present law to a married working couple can under some circumstances amount to less than the benefits that are payable to a married couple with the same total earnings where only one member of the couple worked. (See examples on page 141.)

In view of this difference under the system with respect to the replacement of individual earnings vis-a-vis family earnings, the Subcommittee recommends that a married working couple coming on the benefit rolls in the future with each member of the couple having at least 40 quarters of coverage in the 20 years before entitlement to benefits should have the option of receiving retirement benefits based on the combined earnings of the couple. While the couple's earnings in each year would be combined, no more than the amount of the prevailing tax and benefit base in the year—the maximum amount of a worker's annual earnings that is counted in figuring social security benefits and is subject to social security taxes—could be counted in figuring benefits. Thus the proposal would benefit lower income families, that is, those in which neither worker earns as much as the prevailing tax and benefit base in a year.

Each member of the couple would get a retirement benefit based on a primary insurance amount that was equal to 75 percent of the primary insurance amount resulting from the monthly average of the combined earnings. Together the couple would get benefits based on an amount that was equal to 150 percent of the primary insurance amount resulting from the monthly average of the combined earnings, the same percent that a married couple with the same total earnings in each year would get where only one member of the couple worked.

Each member of a couple would have to have at least 40 quarters of coverage under the social security program in the 20 years before entitlement in order for the couple to elect to receive benefits based on their combined earnings, and both members of the couple would have to elect to receive benefits on this basis or neither of them could. Benefits based on combined earnings would not be payable after a divorce.

A widow or widower who is eligible for a widow's or widower's benefit could get a benefit based on the couple's combined earnings if the couple were receiving benefits based on their combined earnings when one member of the couple died, or if the deceased had 40 quarters of coverage and the survivor had 40 quarters of coverage in the 20 years before entitlement to benefits or the death of the spouse.

All other benefits based on either worker's earnings would be computed on the basis of the worker's individual earnings, as under present law.

2. To improve the protection afforded under social security to regular but low-paid workers, the majority of whom are women, the Subcommittee recommends that the dollar requirement for a year of

coverage after 1950 for purposes of computing the special minimum benefit be reduced from the present one-fourth to one-sixth of the prevailing contribution and benefit base.

General recommendation concerning all social security provisions of the law

In general, words that do not denote gender should be used in the law wherever it is practical to do so, provided no change in the intended meaning of the law would result. For example, where possible it would be preferable for the law to refer to "spouse" instead of to "wife" or "husband", and to "surviving spouse" instead of to "widow" or "widower", etc. The Subcommittee understands that there is a general principle of statutory construction that calls for interpreting words in a provision of law which denote the male sex as meaning either the male or the female sex unless there is something else in the law or in the legislative history of the provision which precludes such an interpretation, and agrees that this should be the case where it is not practical to use words that do not denote gender.

Other major findings

1. The social security law should not be changed to provide social security earnings credits to homemakers for work done in the home for which no earnings are received, nor to permit people to pay social security taxes with respect to such or similar work in or around the home in order to obtain credits. Such a change in the law would be unwise, impractical, and very costly.

There is of course an economic value, however difficult to assess, to the work that women—and men—do in and around their homes, and an economic loss when such work ceases. However, no wages are paid for such work, so there is no loss of earned income that occurs when the work stops, as there is when a wage earner retires, becomes disabled, or dies.

Social security is an earnings-replacement program. Its function is to replace, in part, earnings from work that are cut off by retirement in old age, disability, or death. It would be contrary to the earnings-replacement nature of the social security program to provide for the payment of social security benefits in cases where no loss of earnings occurs, and the Subcommittee believes that it would be undesirable to change the nature and function of the social security program by providing for the payment of benefits under it in such cases.

Another consideration with respect to paying social security taxes to obtain earnings credits for work in and around the home is that those most able to pay such tax are nonworking wives of high-earning men. All workers, part-time, full-time, single or married, could logically feel that this option should be open to them in accordance to the degree that they do work in and around the home. To impute earnings for certain homemaker services without imputing earnings for all types of such services—for example, gardening, housepainting, etc.—would raise serious questions of equity.

2. The social security law should not be changed to provide a married worker some or all of a secondary benefit in addition to his or her primary benefit in all cases. Such a change in the law would create further inequities, and the increase in social security contributions

that would be required to pay for the additional benefits would apply not only to married people but also to single people, who would derive no additional protection from it.

CONCLUSION

The Subcommittee urges the adoption of its recommendations by the full Council.

Respectfully submitted,

RITA R. CAMPBELL,
Chairman.

EDWARD J. CLEARY.

JOHN J. SCANLON.

APPENDIX

SUMMARY LIST OF RECOMMENDATIONS OF THE SUBCOMMITTEE ON THE TREATMENT OF MEN AND WOMEN UNDER SOCIAL SECURITY (WITH RESPECT TO SEX AND MARITAL STATUS), ADVISORY COUNCIL ON SOCIAL SECURITY

Provision of present law

I. Recommendations concerning Social Security provisions of the law that are different for men and women.

A. General recommendation

B. Major provisions

1. To qualify for husband's or widower's insurance benefits under social security based on a wife's earnings, a man must have been receiving at least one-half of his support from his wife when she becomes disabled or entitled to primary social security benefits or dies. There is no such support requirement in the law for women for wife's or widow's insurance benefits based on the husband's earnings.

2. The wife of a worker entitled to old-age or disability insurance benefits under social security, and the widow or surviving divorced wife of a deceased insured worker, may get a wife's or mother's insurance benefit based on the worker's earnings regardless of her age if, among other things, she has in her care a child of the worker under age 18, or age 18 or over and disabled, and entitled to child's insurance benefits on the basis of the worker's earnings. There is no provision in the law for the payment of benefits to fathers in like circumstances.

3. Under certain circumstances an aged divorced wife or aged or disabled divorced widow can get a wife's or widow's insurance benefit based on her former husband's earnings. There is no provision in the law for the payment of husband's and widower's insurance benefits to divorced men in like circumstances.

Recommendation

All social security provisions of the law that are different for men and women should be the same for both in the future.

III. Below also applies.

General recommendation in I. A. above applies. Three alternative methods of accomplishing the recommendation are presented to the Council for its consideration. General recommendation in III. below also applies.

General recommendation in I. A. above applies. Three alternative methods of accomplishing the recommendation are presented to the Council for its consideration. General recommendation in III. below also applies.

General recommendation in I. A. above applies. Three alternative methods of accomplishing the recommendation are presented to the Council for its consideration. General recommendation in III. below also applies.

*Provision of present law**Recommendation*

4. The benefit eligibility and benefit computation provisions of the law are the same for men and women reaching age 62 after 1974. However, the provisions are different for men than they are for women for those who reached age 62 during 1954-1974. In general, for a man reaching age 62 in 1954-74 the amount of work needed to qualify for retirement benefits and the average monthly earnings on which his and his family's social security benefits are based are figured over more years than they are for a woman of the same age.

Do not change (provision is already the same for men and women reaching age 62 in the future).

C. Technical provisions.

1. In general, when a childhood disability beneficiary marries another social security beneficiary, neither's benefits are terminated by reason of the marriage. (In general, the social security law provides for termination of dependents' or dependent survivors' benefits upon marriage. An exception is generally provided by the law, however, when one social security beneficiary marries another.) The law is the same for males and females in this regard. If the benefits of the childhood disability beneficiary are later terminated due to his recovery or ability to work despite his impairment, however, the treatment of the benefits of the other beneficiary varies depending on the sex of the childhood disability beneficiary. If the benefits of a male childhood disability beneficiary are terminated, the female's benefits are also terminated (when he is no longer a beneficiary, she is treated as she would be treated if she had married a nonbeneficiary), but if the benefits of a female childhood disability beneficiary are terminated, the male's benefits continue.

No specific recommendation; general recommendations in I. A. above and III. below apply.

2. A similar situation to that described in C. 1. above exists in the case of a disability insurance beneficiary who marries. In the case of a male disabled worker beneficiary who marries a childhood disability beneficiary or a mother or surviving divorced mother beneficiary, both individuals' benefits continue, but the female's are terminated if the male's disability benefits are terminated because he recovers from his disability or is able to work. In the reverse situation, though, where a female disability beneficiary marries a childhood disability beneficiary (there is currently no benefit for fathers), the male's benefits are not terminated if the female's disability benefits are terminated.

No specific recommendation; general recommendations in I. A. above and III. below apply.

Provision of present law

3. One requirement in the law for entitlement to aged widow's benefits is that she not be married at the time she applies for benefits. The requirement for a widower is that he must not have married by the time he applies for widower's benefits in order to be entitled to such benefits. Thus, a widow may have been remarried, but if she is not married (as a result, say, of a divorce) at the time she applies for benefits, she can become entitled (or reentitled) to benefits on her deceased husband's earnings. For a widower, however, the differing requirement means that if he has remarried, he cannot ever become entitled to widower's benefits based on his first deceased wife's earnings, even if he ceases being married.

4. Under present social security law, a man's illegitimate child who cannot inherit from him under applicable State law relative to devolution of intestate personal property may nevertheless be deemed to be his child for purposes of receiving social security benefits as such if, among other things, the man has been decreed by a court to be the father of the child. There is no such provision in the social security law with respect to such an illegitimate child of a woman. Note: The absence of such a provision with respect to the illegitimate child of a woman has practically no adverse effect because in nearly all States a woman's illegitimate child has the same standing as a woman's legitimate child under intestacy laws, and under the social security law, a man's or woman's illegitimate child who has such standing is deemed to be his or her child for social security benefit purposes. Also, the social security law contains other provisions than the one mentioned above concerning a court decree under which a person's child who cannot inherit from him or her under State intestacy laws may nevertheless be deemed to be the person's child for social security purposes, and these provisions are the same for men and women. In the event that such a child failed to qualify on any other basis, though, the child could not qualify for benefits based on a court decree that a woman was the child's mother, as it could based on a court decree that a man was the child's father.

Recommendation

No specific recommendation; general recommendations in I. A. above and III. below apply.

No specific recommendation; general recommendations in I. A. above and III. below apply.

*Provision of present law**Recommendation*

5. Under a 1965 amendment to the social security law, certain people who attained age 72 before 1969 are eligible for benefits with fewer quarters of coverage than would otherwise be required. Benefits were also provided for certain wives and widows who attained age 72 before 1969 but no benefits were provided for husbands or widowers.

6. Under a 1966 amendment to the social security law, special payments are made (out of general revenues for the most part) to certain people who reached age 72 before 1972 and who have not worked long enough in jobs covered by the social security program to qualify for regular monthly case benefits. The amount of the special payment for for a couple—\$96.60—is not divided equally between the husband and the wife. The payment is \$64.40 for the husband and \$32.20 for the wife. In effect, the couple is treated as though the husband was a retired worker and the wife a dependent even though each must meet the same eligibility requirements he or she would have to meet if not married.

7. The community property statutes of Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Puerto Rico provide that a husband and wife have equal rights to the income from a business operated by either one or by both. The Social Security Act provides that where a community property law applies and there is no legal partnership, all of the income from a business will be treated as the income of the husband unless the wife exercises substantially all of the management and control of the trade or business, in which case the income will be treated as hers. The intent of this provision is to assure that a person who operates a business in a community property State will, like a person in a noncommunity property State, get social security credit for his or her earnings notwithstanding the State community property statute. (The social security law generally provides that, absent a legal partnership, earnings from self-employment are creditable to the person who has primary responsibility for the management and control of the business.)

II. Recommendations concerning Social Security provisions of the law that are the same for men and women.

No specific recommendation; general recommendations in I. A. above and III. below apply.

No specific recommendation; general recommendations in I. A. above and III. below apply.

No specific recommendations; general recommendations in I. A. above and III. below apply.

III. Below also applies.

Provision of present law

A. The retirement benefits that are payable under present law to a married working couple can under some circumstances amount to less than the benefits that are payable to a married couple with the same total earnings where only one member of the couple worked.

B. The special minimum benefit is equal to \$9 multiplied by the number of years of coverage an individual has under the program in excess of 10 and up to a maximum of 30 years. For purposes of this provision, a year of coverage after 1950 is a year in which a person has earnings at least equal to one-fourth of the contribution and benefit base for the year.

III. Recommendation concerning all Social Security provisions of the law.

Recommendation

Eliminate this anomaly for those married working couples becoming entitled to benefits in the future in which each member of the couple has at least 40 quarters of coverage under the program in the 20 years before entitlement to benefits by permitting such a couple to receive retirement benefits based on their combined earnings.

Reduce the dollar requirement for a year of coverage after 1950 for purposes of computing the special minimum benefit, for beneficiaries on the rolls and new entitlements, from the present one-quarter ($\frac{1}{4}$) to one-sixth ($\frac{1}{6}$) of the prevailing contribution and benefit base.

In general, words that do not denote gender should be used in the law wherever it is practical to do so, provided no change in the intended meaning of the law would result. For example, where possible it would be preferable for the law to refer to "spouse" instead of to "wife" or "husband," and to "surviving spouse" instead of "widow" or "widower," etc. The Subcommittee understands that there is a general principle of statutory construction that calls for interpreting words in a provision of law which denote the male sex as meaning either the male or the female sex unless there is something else in the law or in the legislative history of the provision which precludes such an interpretation, and agrees that this should be the case where it is not practical to use words that do not denote gender.

APPENDIX C

STATUTORY AUTHORITY FOR ADVISORY COUNCIL ON SOCIAL SECURITY

EXCERPT FROM THE SOCIAL SECURITY ACT, AS AMENDED

Advisory Council on Social Security

Sec. 706.(a) During 1969 (but not before February 1, 1969) and every fourth year thereafter (but not before February 1 of such fourth year), the Secretary shall appoint an Advisory Council on Social Security for the purpose of reviewing the status of the Federal Old-Age and Survivors Insurance Trust Fund, the Federal Disability Insurance Trust Fund, the Federal Hospital Insurance Trust Fund, and the Federal Supplementary Medical Insurance Trust Fund in relation to the long-term commitments of the old-age, survivors, and disability insurance program and the programs under parts A and B of title XVIII, and of reviewing the scope of coverage and the adequacy of benefits under, and all other aspects of, these programs, including their impact on the public assistance programs under this Act.

(b) Each such Council shall consist of a Chairman and 12 other persons, appointed by the Secretary without regard to the provisions of title 5, United States Code, governing appointments in the competitive service. The appointed members shall, to the extent possible, represent organizations of employers and employees in equal numbers, and represent self-employed persons and the public.

(c)(1) Any Council appointed hereunder is authorized to engage such technical assistance, including actuarial services, as may be required to carry out its functions and the Secretary shall, in addition, make available to such Council such secretarial, clerical, and other assistance and such actuarial and other pertinent data prepared by the Department of Health, Education, and Welfare as it may require to carry out such functions.

(2) Appointed members of any such Council, while serving on business of the Council (inclusive of travel time) shall receive compensation at rates fixed by the Secretary, but not exceeding \$100 per day and, while so serving away from their homes or regular places of business, they may be allowed travel expenses, including per diem in lieu of subsistence, as authorized by section 5703 of title 5, United States Code, for persons in the Government employed intermittently.

(d) Each such Council shall submit reports (including any interim reports such Council may have issued) of its findings and recommendations to the Secretary not later than January 1 of the second year after the year in which it is appointed, and such reports and recommendations shall thereupon be transmitted to the Congress and to the Board of Trustees of each of the Trust Funds. The reports required by this subsection shall include—

(1) A separate report with respect to the old-age, survivors, and disability insurance program under title II and of the taxes imposed under sections 1401(a), 3101(a), and 3111(a) of the Internal Revenue Code of 1954,

(2) A separate report with respect to the hospital insurance program under part A of title XVIII and of the taxes imposed by sections 1401(b), 3101(b), and 3111(b) of the Internal Revenue Code of 1954, and

(3) A separate report with respect to the supplementary medical insurance program established by part B of title XVIII and of the financing thereof.

After the date of the transmittal to the Congress of the reports required by this subsection, the Council shall cease to exist.

APPENDIX D

FINDINGS AND RECOMMENDATIONS OF PREVIOUS ADVISORY COUNCILS ON SOCIAL SECURITY

This paper is a list of the recommendations of five previous Advisory Councils on Social Security—1938, 1948, 1959, 1965, and 1971. The paper also indicates what action—whether immediate or eventual—was taken upon each recommendation. The recommendations are not broken down by subject area, but are listed as they appear in that particular Council's report.

The recommendations of the 1953 Consultants on Social Security and the 1968 Advisory Council on Health Insurance for the Disabled

are not included in this paper since the scope of their review was comparatively limited. The major recommendations of the 1953 Consultants involved extensions of social security coverage to additional areas of employment and self-employment and have generally been enacted.

The statutory 1968 Advisory Council on Health Insurance for the Disabled recommended that Medicare protection be extended to disabled social security beneficiaries and certain disabled people who did not meet the requirements for cash disability benefits, with both the hospital insurance and the medical insurance parts of the program financed on the basis of payroll contributions and a 50 percent contribution from general revenues. Under the 1972 legislation, Medicare protection was extended to people who have been getting disability benefits for 24 months; other aspects of the 1968 Council's recommendation were not enacted.

1938 ADVISORY COUNCIL ON SOCIAL SECURITY

Council's recommendation

Action

A. RECOMMENDATIONS ON BENEFITS

I. The average old-age benefits payable in the early years under title II should be increased.¹

I. Benefits increased under 1939 Act by basing benefits on average rather than total earnings.

II. The eventual annual cost of the insurance benefits now recommended, in relation to covered pay roll and from whatever source financed, should not be increased beyond the eventual annual disbursements under the 1935 act.

II. Recommendation followed. Benefits provided under 1939 amendments did not increase eventual annual disbursements in relation to covered payroll over those under 1935 Act.

III. The enhancement of the early old-age benefits under the system should be partly attained by the method of paying in the case of a married annuitant a supplementary allowance on behalf of an aged wife equivalent to 50 percent of the husband's own benefit; *provided*, that should a wife after attaining age 65 be otherwise eligible to a benefit in her own right which is larger in amount than the wife's allowance payable to her husband on her behalf, the benefit payable to her in her own right will be substituted for the wife's allowance.

III. Enacted in 1939.

IV. The minimum age of a wife for eligibility under the provision for wives' supplementary allowances should be 65 years; *provided*, that marital status had existed prior to the husband's attainment of age 60.

IV. Enacted in 1939 with provision that marital status existed before January 1, 1939 or prior to the husband's attainment of age 60.

V. The widow of an insured worker, following her attainment of age 65, should receive an annuity bearing a reasonable relationship to the worker's annuity; *provided*, that marital status had existed prior to the husband's attainment of age 60 and 1 year preceding the death of the husband.

V. Enacted in 1939, but without provision that marital status existed prior to husband's attainment of age 60.

¹ "Title II" refers to the title of the Social Security Act which provides for the social security cash benefit program.

*Council's recommendation**Action*

VI. A dependent child of a currently insured individual upon the latter's death prior to age 65 should receive an orphan's benefit, and a widow of a currently insured individual, provided she has in her care one or more dependent children of the deceased husband, should receive a widow's benefit.

VI. Enacted in 1939.

VII. The provision of benefits to an insured person who becomes permanently and totally disabled and to his dependents is socially desirable. On this point the council is in unanimous agreement. There is difference of opinion, however, as to the timing of the introduction of these benefits. Some members of the council favor the immediate inauguration of such benefits. Other members believe that on account of additional costs and administrative difficulties, the problem should receive further study.

VII. Benefits for disabled workers provided under 1956 Act; for dependents of disabled workers under 1958 Act.

VIII. In order to compensate in part for the additional cost of the additional benefits herein recommended, the benefits payable to individuals as single annuitants after the plan has been in operation a number of years should be reduced below those now incorporated in title II. If the national income should increase in future years, these reductions may not be necessary.

VIII. Not enacted.

IX. The death benefit payable on account of coverage under the system should be strictly limited in amount and payable on the death of any eligible individual.

IX. 1939 Act limited lump-sum death benefit to six times the PIA.

X. The payment of old-age benefits should be begun on January 1, 1940.

X. Enacted in 1939.

B. RECOMMENDATIONS OF COVERAGE

I. The employees of private nonprofit religious, charitable, and educational institutions now excluded from coverage under titles II and VIII should immediately be brought into coverage under the same provisions of these titles as affect other covered groups.²

I. Coverage extended on a elective basis to employees of nonprofit organizations by 1950 Act and to ministers by 1954 Act; on a compulsory basis to ministers by 1967 Act.

II. The coverage of farm employees and domestic employees under titles II and VIII is socially desirable and should take effect, if administratively possible, by January 1, 1940.

II. Enacted in 1950.

² "title VIII" refers to the title of the Social Security Act of 1935 which provided for social security taxes with respect to covered employment. This title has been superseded by Chapter 21 of the Internal Revenue Code of 1954.

*Council's recommendation**Action*

III. The old-age insurance program should be extended as soon as feasible to include additional groups not included in the previous recommendations of the council and studies should be made of the administrative, legal, and financial problems involved in the coverage of self-employed persons and governmental employees.

III. Coverage extended to various other groups over the years.

C. RECOMMENDATIONS ON FINANCE

I. Since the nation as a whole, independent of the beneficiaries of the system, will derive a benefit from the old-age security program, it is appropriate that there be Federal financial participation in the old-age insurance system by means of revenues derived from sources other than pay-roll taxes.

I. Provision for general revenue contribution if needed enacted in 1944, but never used and repealed in 1950.

II. The principle of distributing the eventual cost of the old-age insurance system by means of approximately equal contributions by employers, employees, and the Government is sound and should be definitely set forth in the law when tax provisions are amended.

II. Not enacted.

III. The introduction of a definite program of Federal financial participation in the system will affect the consideration of the future rates of taxes on employers and employees and their relation to future benefit payments.

III. Not enacted.

IV. The financial program of the system should embody provision for a reasonable contingency fund to insure the ready payment of benefits at all times and to avoid abrupt changes in tax and contribution rates.

IV. Over the years, program financing has followed this recommendation.

V. The planning of the old-age insurance program must take full account of the fact that, while disbursements for benefits are relatively small in the early years of the program, far larger total disbursements are inevitable in the future. No benefits should be promised or implied which cannot be safely financed not only in the early years of the program but when workers now young will be old.

V. This policy has been followed.

VI. Sound presentation of the government's financial position requires full recognition of the obligations implied in the entire old-age security program and treasury reports should annually estimate the load of future benefits and the probable product of the associated tax program.

VI. The 1939 amendments required that this be done in annual reports of Boards of Trustees.

Council's recommendation

VII. The receipts of the taxes levied in title VIII of the law, less the costs of collection, should through permanent appropriation be credited automatically to an old-age insurance fund and not to the general fund for later appropriation to the account, in whole or in part, as Congress may see fit. It is believed that such an arrangement will be constitutional.

VIII. The old-age insurance fund should specifically be made a trust fund, with designated trustees acting on the behalf of the prospective beneficiaries of the program. The trust fund should be dedicated exclusively to the payment of the benefits provided under the program and, in limited part, to the costs necessary to the administration of the program.

IX. The consideration of change in the tax schedule under title VIII of the law should be postponed until after the rates of 1½ percent each on employer and employee are in effect since information will not be available for some time concerning (a) tax collections under varying conditions, (b) effective coverage under taxes and benefits, (c) average covered earnings, period of coverage, time of retirement, and average amount of benefits, (d) the possibilities of covering farm labor, domestic employees or self-employed persons, and (e) the possibilities of introducing new types of benefits.

X. The problem of the timing of the contributions by the government, taking into account the changing balance between pay-roll-tax income and benefit disbursements, is of such importance as to require thorough study as information is available.

XI. Following the accumulation of such information, this problem should be restudied for report not later than January 1, 1942, as to the proper planning of the program of pay-roll taxes and governmental contributions to the old-age insurance system thereafter, since by that time experience on the basis of 5 years of tax collections and 2 years of benefit payments (provided the present act is amended to that effect) will be available. Similar studies should be made at regular intervals following 1942.

Action

VII. The 1939 amendments established an OAI fund (in place of the "old-age reserve account"). (The taxes go into the general fund and then are automatically appropriated to the trust fund.)

VIII. Enacted in 1939.

IX. Not followed; 1939 Act delayed increase in contribution rates to 1½ percent.

X. Not applicable, see financing recommendation C., I. above.

XI. Same as above

1948 ADVISORY COUNCIL ON SOCIAL SECURITY

*Council's recommendation**Action*

1. *Self-employment.*—Self-employed persons such as business and professional people, farmers, and others who work on their own account should be brought under coverage of the old-age and survivors insurance system. Their contributions should be payable on their net income from self-employment, and their contribution rate should be $1\frac{1}{2}$ times the rate payable by employees. Persons who earn very low incomes from self-employment should for the present remain excluded.

2. *Farm workers.*—Coverage of the old-age and survivors insurance system should be extended to farm employees.

3. *Household workers.*—Coverage of the old-age and survivors insurance system should be extended to household workers.

4. *Employees of nonprofit institutions.*—Employment for nonprofit institutions now excluded from coverage under the old-age and survivors insurance program should be brought under the program, except that clergymen and members of religious orders should continue to be excluded.

5. *Federal civilian employees.*—Old-age and survivors insurance coverage should be extended immediately to the employees of the Federal Government and its instrumentalities who are now excluded from the civil-service retirement system. As a temporary measure designed to give protection to the short-term Government worker, the wage credits of all those who die or leave Federal employment with less than 5 years' service should be transferred to old-age and survivors insurance. The Congress should direct the Social Security Administration and the agencies administering the various Federal retirement programs to develop a permanent plan for extending old-age and survivors insurance to all Federal civilian employees, whereby the benefits and contributions of the Federal retirement systems would supplement the protection of old-age and survivors insurance and provide combined benefits at least equal to those now payable under the special retirement systems.

1. Coverage of nonfarm self-employed (except professional groups) enacted in 1950. Professional self-employed covered by amendments in 1954, 1956, and 1965. The 1950 Act set the contribution rate for the self-employed at $1\frac{1}{2}$ times the rate paid by employees.

2. Coverage of some farm employees enacted in 1950. Additional farm employees covered by amendments in 1954 and 1956.

3. Coverage of some household employees enacted in 1950. Additional household employees covered by 1954 amendments.

4. Coverage on an elective basis of employees of nonprofit organizations enacted in 1950.

5. Coverage of Federal civilian employees not under a retirement system enacted in 1950. Rest of recommendation not enacted.

*Council's recommendation**Action*

6. *Railroad employees.*—The Congress should direct the Social Security Administration and the Railroad Retirement Board to undertake a study to determine the most practicable and equitable method of making the railroad retirement system supplementary to the basic old-age and survivors insurance program. Benefits and contributions of the railroad retirement system should be adjusted to supplement the basic protection afforded by old-age and survivors insurance, so that the combined protection of the two programs would at least equal that under the Railroad Retirement Act.

7. *Members of the armed forces.*—Old-age and survivors insurance coverage should be extended to members of the armed forces, including those stationed outside the United States.

8. *Employees of State and local governments.*—The Federal Government should enter into voluntary agreements with the States for the extension of old-age and survivors insurance to the employees of State and local governments, except that employees engaged in proprietary activities should be covered compulsorily.

9. *Social security in island possessions.*—A commission should be established to determine the kind of social-security protection appropriate to the possessions of the United States.

10. *Inclusion of tips as wages.*—The definition of wages as contained in section 209(a) of the Social Security Act, as amended, and section 1426(a) of subchapter A of chapter 9 of the Internal Revenue Code should be amended to specify that such wages shall include all tips or gratuities customarily received by an employee from a customer of an employer.

11. *Insured status.*—To permit a larger proportion of older workers, particularly those newly covered, to qualify for benefits, the requirements for fully insured status should be 1 quarter of coverage for each 2 calendar quarters elapsing after 1948 or after the quarter in which the individual attains the age of 21, whichever is later, and before the quarter in which he attains the age of 65 (60 for women) or dies. Quarters

6. Under 1951 amendments, credits for work covered by the Railroad Retirement Act transferred to social security if an employee, at retirement, disablement, or death, has less than 10 years of railroad service. Rest of recommendation not enacted.

7. Enacted in 1956.

8. Coverage, under voluntary agreements with States, of State and local government employees not under a retirement system enacted in 1950; those under a retirement system covered by 1954 amendments.

9. Coverage of workers in some U.S. possessions enacted in 1950 and in 1960.

10. Enacted in 1965, but no employer contribution on tips required.

11. Substantially enacted in 1950.

*Council's recommendation**Action*

of coverage earned at any time after 1936 should count toward meeting this requirement. A minimum of 6 quarters of coverage should be required and a worker should be fully and permanently insured if he has 40 quarters of coverage. In cases of death before January 1, 1949, the requirement should continue to be 1 quarter of coverage for each 2 calendar quarters elapsing after 1936 or after the quarter in which the age of 21 was attained, whichever is later, and before the quarter in which the individual attained the age of 65 or died.

12. *Maximum base for contributions and benefits.*—To take into account increased wage levels and costs of living, the upper limit on earnings subject to contributions and credited for benefits should be raised from \$3,000 to \$4,200. The maximum average monthly wage used in the calculation of benefits should be increased from \$250 to \$350.

13. *Average monthly wage.*—The average monthly wage should be computed as under the present law, except that any worker who has had wage credits of \$50 or more in each of six or more quarters after 1948 should have his average wage based either on the wages and elapsed time counted as under the present law or on wages and elapsed time after 1948, whichever gives the higher result.

14. *Benefit formula.*—To provide adequate benefits immediately and to remove the present penalty imposed on workers who lack a lifetime of coverage under old-age and survivors insurance, the primary insurance benefit should be 50 percent of the first \$75 of the average monthly wage plus 15 percent of the remainder up to \$275. Present beneficiaries, as well as those who become entitled in the future, should receive benefits computed according to this new formula for all months after the effective date of the amendments.

15. *Increased survivor protection.*—To increase the protection for a worker's dependents, survivor benefits for a family should be at the rate of three-fourths of the primary insurance benefit for one child and one-half for each additional child, rather than one-half for all children as at present. The parent's benefit should also be increased from one-half to three-fourths. Widows' benefits should remain at three-fourths of the primary insurance benefit.

12. 1950 legislation raised base from \$3,000 to \$3,600 beginning in 1951.

13. Substantially enacted in 1950; AMW computed using years after 1950 (or year aged 21) instead of after 1948.

14. Substantially enacted in 1950; PIA made 50 percent of first \$100 plus 15 percent of next \$200 of AMW, effective for April 1952.

15. Substantially enacted in 1960; a surviving child receives three-fourths of the primary insurance benefit. Parents benefits increased from one-half to three-fourths in 1950.

*Council's recommendation**Action*

16. *Dependents of insured women.*—To equalize the protection given to the dependents of women and men, benefits should be payable to the young children of any currently insured woman upon her death or eligibility for primary insurance benefits. Benefits should be payable also (a) to the aged, dependent husband of a primary beneficiary who, in addition to being fully insured, was currently insured at the time she became eligible for primary benefits, and (b) to the aged, dependent widower of a woman who was fully and currently insured at the time of her death.

17. *Maximum benefits.*—To increase the family benefits, the maximum benefit amount payable on the wage record of an insured individual should be three times the primary insurance benefit amount or 80 percent of the individual's average monthly wage, whichever is less, except that this limitation should not operate to reduce the total family benefits below \$40 a month.

18. *Minimum benefit.*—The minimum primary insurance benefit payable should be raised to \$20.

19. *Retirement test.*—No retirement test (work clause) should be imposed on persons aged 70 or over. At lower ages, however, the benefits to which a beneficiary and his dependents are entitled for any month should be reduced by the amount in excess of \$35 which he earns from covered employment in that month. Benefits should be suspended for any month in which such earnings exceed \$35 but, each quarter, beneficiaries should receive the amount by which the suspended benefits exceeded earnings above the exemption.

20. *Qualifying age for women.*—The minimum age at which women may qualify for old-age benefits (primary, wife's, widow's, parent's) should be reduced to 60 years.

21. *Lump-sum benefits.*—To help meet the special expenses of illness and death, a lump-sum benefit should be payable at the death of every insured worker even though monthly survivor benefits are payable. The maximum payment should be four times the primary insurance benefit rather than six times as at present.

16. Enacted in 1950.

17. Substantially enacted in 1950, but without the alternative of 3 times the primary insurance amount.

18. Enacted in 1950.

19. Principle of the provision enacted in 1950; exempt age 75 instead of 70, and exempt amount \$50 instead of \$35. 1950 amendments did not provide for quarterly payment of excess benefit amounts withheld.

20. Under the 1956 amendments the eligibility age for women was reduced from 65 to 62 instead of 60 as recommended.

21. Similar provision enacted in 1950; maximum payment set at three times the PIA. The 1954 amendments established a maximum lump-sum payment of \$225. This limit now governs all lump-sum payments since 3 times the minimum PIA is now more than \$225.

Council's recommendation

22. *Contribution schedule and Government participation.*—The contribution rate should be increased to 1½ percent for employers and 1½ percent for employees at the same time that benefits are liberalized and coverage is extended. The next step-up in the contribution rate, to 2 percent on employer and 2 percent on employee, should be postponed until the 1½-percent rate plus interest on the investments of the trust fund is insufficient to meet current benefit outlays and administrative costs. There are compelling reasons for an eventual Government contribution to the system, but the Council feels that it is unrealistic to decide now on the exact timing or proportion of that contribution. When the rate of 2 percent on employers and 2 percent on employees plus interest on the investments of the trust fund is insufficient to meet current outlays, the advisability of an immediate Government contribution should be considered.

Action

22. Under 1950 amendments, contribution rate increased to 1.5 percent for 1951 and 2 percent in 1954. No government contribution authorized.

1959 ADVISORY COUNCIL ON SOCIAL SECURITY FINANCING

*Council's recommendation**Action*

THE MAJOR FINDING

The method of financing the old-age, survivors, and disability insurance program is sound, and, based on the best estimates available, the contribution schedule now in the law makes adequate provision for meeting both short-range and long-range costs.

Endorsement of existing policy; no action necessary.

CONTRIBUTIONS BY EMPLOYEES, EMPLOYERS, AND THE SELF-EMPLOYED

A. The Council believes that, as provided in present law, a substantial part of the cost of this program should be borne directly by those who benefit from it.

A. Same as above.

B. The Council believes that it is also appropriate for a substantial part of the cost of the program to be borne by an employer contribution and for the self-employed to pay a rate equal to one and one-half times the employee rate.

B. Same as above. (1965 Council recommended reduction in relative size of the tax rate for the self-employed.)

*Council's recommendation**Action*THE EARNINGS BASE FOR CONTRIBUTIONS
AND BENEFITS

In an economy characterized by rising wages and salaries it is necessary to give periodic review to the maximum amount of earnings subject to contributions and credited toward benefits, since this maximum determines the proportion of the covered payrolls available to finance the program and is a major factor in determining the extent to which the program pays benefits reasonably related to the past earnings of the individual.

Endorsement of existing policy; no action necessary.

THE SCHEDULE OF CONTRIBUTION RATES

A. The Council endorses the contribution schedule in present law on the basis of the cost estimates we have reviewed. We believe that the 1959, 1960, and 1963 rate increases should go into effect as scheduled and that conditions will probably warrant the 1966 rate increase as well. The last increase—that scheduled for 1969—will need to be evaluated in the light of the conditions current at that time and in the light of the cost estimates then available.

A. New contribution rate schedule enacted in 1961.

B. The Council believes that the establishment of a contribution schedule in the law based on the concept of long-range actuarial balance is sound policy and should be continued. However, future decisions concerning the financing of the program should increasingly take into account estimates of trust fund income and outgo over the ensuing 15 or 20 years based on expected earnings and employment levels and on demographic developments.

B. Policy essentially followed.

THE ROLE OF THE TRUST FUNDS

A. The Council approves of the accumulation of funds that are more than sufficient to meet all foreseeable short-range contingencies, and that will therefore earn interest in somewhat larger amounts than would be earned if the funds served only a contingency purpose. The Council concludes, however, that a "full" reserve is unnecessary and does not believe that interest earnings should be expected to meet a major part of the long-range benefit costs.

A. Endorsement of existing policy; no action necessary. Both the 1965 and 1971 Councils recommended financing policies, which were adopted, which have the result of reducing the relative role of interest earnings in the financing of the program. In particular the 1971 Council specifically recommended that the funds be maintained at a contingency reserve level.

*Council's recommendation**Action*

B. The investment of the trust funds in United States Government obligations is a proper use of the excess of income over outgo for the benefit of the contributors to the funds. The trust funds are properly kept separate from the general fund of the Treasury and have the same lender status as other investors in Federal securities.

B. Same as above.

THE MANAGEMENT AND INVESTMENT OF
THE TRUST FUNDS

A. The investment of the trust funds should continue to be restricted to interest-bearing obligations of the United States Government or to obligations guaranteed as to principal and interest by the United States.

A. Same as above.

B. The investment of the trust funds should be in obligations having maturities which reasonably reflect the long-term character of the funds.

B. Policy adopted by Boards of Trustees.

C. Each special obligation issued for purchase by the trust funds should carry a rate of interest that, in principle, equals the rate of return being realized by investors who purchase long-term Government securities in the open market at the time the special obligation is issued.

C. Enacted in 1960.

D. Investment of the trust funds, as at present, should be either in special issues or in public issues, but the statute should be amended to provide that public issues may be acquired only when they will provide currently a yield equal to or greater than the yield that would be provided by the alternative of investing in special issues.

D. Statute not amended, but recommendation followed in practice.

E. The law should be amended to state that the Board of Trustees as a whole has the responsibility to review the general policies followed in managing the trust funds, and to recommend changes, as needed, in the provisions of the law that govern the way in which the trust funds are to be managed. In keeping with the nature of its responsibilities, the intervals between meetings of the Board should be not more than 6 months.

E. Enacted in 1960. (However, 1965 amendments changed the interval between meetings back to 1 year.)

F. The Council has examined broadly the way administrative expenses are charged to the trust funds and the financial provisions relating to the Railroad Retirement Account and to the coverage of the members of the armed forces and believes that the arrangements are fair.

F. Endorsement of existing laws and practices.

1965 ADVISORY COUNCIL ON SOCIAL SECURITY

*Council's recommendation**Action*

I. FINANCING THE PRESENT PROGRAM

1. *The Status of the Program and Allocation of Contribution Income.*—The social security program as a whole is soundly financed, its funds are properly invested, and on the basis of actuarial estimates that the Council has reviewed and found sound and appropriate, provision has been made to meet all of the costs of the program both in the short run and over the long-range future. The contribution income should be reallocated between the two trust funds, however, so that the disability insurance part of the program, like the old-age and survivors insurance part of the program and the program as a whole, will be in close actuarial balance.

2. *Adjustment in the Contribution Rate Schedule in the Short Range.*—The contribution rates now scheduled in the law should be adjusted to avoid the rapid increase in trust fund assets that will otherwise begin with the rate increases scheduled for 1966 and 1968.

3. *The Contribution Rates in the Long Range.*—There should continue to be included in the law a schedule of contribution rates which, according to the intermediate-cost estimates, will be sufficient to support the program over the long-range future. However, decisions about putting future rate increases into effect, once the rates actually being charged are high enough to cover the long-range cost of the program as shown by a reasonable minimum estimate, should be guided largely by estimates of program costs over a 15- or 20-year period.

4. *The Contribution and Benefit Base.*—The maximum amount of annual earnings that is taxable and creditable toward benefits needs to be substantially increased in order to maintain the wage-related character of the benefits, to restore a broader financial base for the program and to apportion the cost of the system among low-paid and higher-paid workers in the most desirable way.

5. *The Contribution Rate for the Self-Employed.* Increases in the social security contribution rate for the self-employed beyond the present rate should be put into effect gradually, and only to the extent that the ultimate rate will be no more than 1 percent of earnings greater than the rate paid by employees.

1. First part an endorsement of existing law; no action necessary.

Enacted in 1965; allocation to DI trust fund increased.

2. Enacted in 1965.

3. Policy essentially followed.

4. Base substantially increased by 1965 Act.

5. Not enacted.

Council's recommendation

6. *Maintaining the Integrity of the Trust Funds.*—To maintain the integrity of the trust funds, the reimbursement of the trust funds for the cost of paying social security benefits based on military service for which no contributions were paid should begin without further delay and the Board of Trustees should be given specific responsibility for reviewing those administrative charges against the trust funds which are based on estimates rather than on actual costs.

II. HOSPITAL INSURANCE FOR OLDER PEOPLE AND THE DISABLED

1. *Inpatient Hospital Benefits.*—The proposed hospital insurance for people age 65 or over and the disabled should cover a number of days sufficient to meet the cost of inpatient hospital services for the full stay of almost all beneficiaries.

2. *Outpatient Hospital Diagnostic Services.*—Payment under the program should be made for the costs of outpatient hospital diagnostic services furnished beneficiaries.

3. *Deductibles.*—Hospitalized beneficiaries should pay a deductible equal to the cost of one-half day of care—\$20 at the program's beginning. In the case of beneficiaries who are provided outpatient diagnostic services, this deductible amount should be applied for each 30-day period during which diagnostic services are provided.

Action

6. Enacted in 1965.

1. Enacted in 1965 for people age 65 and older; extended to beneficiaries who have been receiving benefits for at least 24 consecutive months on the basis of their disability in 1972. Each benefit period consists of 90 days of covered inpatient hospital services. In 1967 a lifetime reserve of 60 additional days of inpatient hospital service was added. The 1965 law also included supplementary medical insurance, which provides coverage for physicians' care and other medical services.

2. Enacted in 1965.

3. Substantially enacted in 1965. The deductible for the first 60 days of inpatient care is equivalent to the national average cost per patient day of hospital care—currently \$84. For the 61st through the 90 day, there is a daily coinsurance equal to one-fourth of the hospital deductible; for each hospital lifetime reserve day used, the daily coinsurance is one-half of the deductible. For posthospital extended care service the coinsurance is one-eighth of the deductible a day for the 21st through the 100th day. Under the supplementary medical insurance program, the deductible is \$60 and the coinsurance amount is 20 percent of charges over \$60. Coverage of outpatient hospital diagnostic services, originally covered under the hospital insurance program, was transferred to the supplementary medical insurance program in 1967 and is subject to a \$60 deductible and 20 percent coinsurance.

*Council's recommendation**Action*

4. *Services in Extended-Care Facilities.*—The cost of posthospitalization extended-care services in facilities which provide high-quality rehabilitative and convalescent services should be covered so as to pay for a minimum number of days after hospitalization in all cases, with additional days of extended-care services being paid for if the patient has not used all of his inpatient hospital coverage.

5. *Organized Home Nursing Services.*—Insurance coverage should be provided for organized home nursing services.

6. *Payments on the Basis of Reasonable Cost.*—The extent of hospital insurance and related protection should be specified in terms of the services covered rather than in terms of fixed dollars, and covered services should be paid for on the basis of the full reasonable cost of the services.

7. *Hospital Staff Review of Utilization.*—Hospitals should be required, as a condition of participation, to establish professional staff committees to review the services utilized.

8. *Administration.*—The proposed hospital insurance provisions should be administered by the same Federal agencies which administer the social security program but in carrying out this responsibility the Federal Government should use private and State agencies to the extent that these agencies can contribute to efficient and effective operation.

9. *The Basis of Eligibility for Benefits.*—Hospital insurance benefits should be provided for aged and disabled beneficiaries of the social security program, and special provision should be made for the next few years for those who have not met the requirements of eligibility under the program.

10. *Financing.*—The proposed hospital insurance program should be financed by a special earmarked contribution of 0.4 percent of covered earnings from employees and from employers, and 0.5 percent from the self-employed, with an 0.15 percent contribution from Federal general revenues to cover the cost of benefits for those already retired or disabled.

4. Substantially enacted in 1965. No provision was included for substitution of additional extended care days for unused hospital days.

5. Enacted in 1965.

6. Enacted in 1965.

7. Enacted in 1965 and modified in 1972.

8. Enacted in 1965.

9. Enacted in 1965 for all persons age 65 and over; extended to disabled persons who have been receiving social security or railroad retirement benefits for 2 consecutive years or more on the basis of their disability in 1972.

10. Enacted in 1965, Contribution rate for employees, employers, and the self-employed was set at 0.35 percent each for 1966. The current rate is 0.9 percent each.

*Council's recommendation**Action*

III. IMPROVEMENTS IN THE CASH-BENEFIT PROVISIONS

1. *The Period for Computing Benefits for Men.*—The period for computing benefits (and insured status) for men should be based, as is now the case for women, on the period up to the year of attainment of age 62, in stead of age 65 as under present law, with the result that 3 additional years of low earnings would be dropped from the computation of retirement benefits for men.

2. *A General Increase in Benefits.*—A general increase in benefit amounts, accomplished by a change in the way the benefit formula is constructed, should be provided to take into account increases in wages and prices since the last general benefit increase in 1958, and the maximum on monthly family benefits should be related to earnings throughout the benefit range.

3. *The maximum Lump-Sum Death Payment.*—The maximum lump-sum death payment should not be set in terms of an absolute dollar limit but rather should be the same as the highest family maximum monthly benefit.

DEPENDENTS' AND SURVIVORS' BENEFITS

4. *Children Over Age 18 Attending School.*—Benefits should be payable to a child until he reaches age 22, provided the child is attending school between ages 18 and 22.

5. *Disabled Widows.*—The disabled widow of an insured worker, if she became disabled before her husband's death or before her youngest child became 18, or within a limited period after either of these events, should be entitled to widow's benefits regardless of her age.

6. *Definition of Child.*—A child should be paid benefits based on his father's earnings without regard to whether he has the status of a child under State inheritance laws if the father was supporting the child or had a legal obligation to do so.

DISABILITY BENEFITS

7. *Young Disabled Workers.*—Young workers who become disabled should have their eligibility for benefits determined on the basis of a test of substantial and recent employment that is appropriate for such workers.

1. Shortened benefit computation period for men enacted in 1972, but prospective only—not for those already on the rolls.

2. Benefits increased in 1965; guaranteed an increase of 7 percent or \$4 in benefit level, whichever was higher, effective for January 1, 1965. Change in the construction of the benefit formula not enacted.

3. Not enacted.

4. Enacted in 1965. Extended in 1972 to end of quarter or semester in which 22nd birthday occurs.

5. Partially enacted in 1967—benefits provided for disabled widows and widowers at age 50.

6. Substantially enacted in 1965.

7. Enacted in 1967; workers disabled before age 31 must have quarters of coverage equal to one-half the quarters elapsing after age 21 up to disablement, with a minimum of 6 such quarters.

*Council's recommendation**Action*

8. *Rehabilitation of Disability Beneficiaries.*—The social security program should pay the costs of rehabilitation for disability beneficiaries likely to be returned to gainful work through such help, with the rehabilitation services being provided through State vocational rehabilitation agencies.

8. Enacted in 1965.

ELIGIBILITY FOR BENEFITS

9. *Insured Status.*—The Council recommends retention of a requirement of covered work as a test of eligibility for benefits, and has no major changes to recommend in the present provisions.

9. Endorsement of existing law; no legislation necessary.

10. *Retirement Test.*—The provision in the law that prevents the payment of benefits to a person with substantial earnings from current work—the retirement test—is essential in a program designed to replace lost work income and should be retained.

10. Endorsement of existing law; no legislation necessary (Test retained but exempt amount and reduction factor changed in subsequent legislation.)

EXTENDING THE COVERAGE OF THE PROGRAM

11. *Doctors of Medicine.*—Self-employed doctors of medicine should be covered on the same basis as other self-employed people now covered, and interns should be covered on the same basis as other employees working for the same employer.

11. Enacted in 1965.

12. *Tips.*—Social security contributions should be paid on tips an employee receives from a customer of his employer, and tips should be counted toward benefits.

12. Enacted in 1965, but no employer contributions on tips required.

13. *Federal Employees.*—Social security credit should be provided for the Federal employment of workers whose Federal service was covered under the civil service retirement system but who are not protected under that system at the time they retire, become disabled, or die.

13. Not enacted.

14. *State and Local Government Employees.*—The coverage of additional State and local government employees should be facilitated by making available to all States the option of covering only those present members of State and local government retirement system groups who wish to be covered, with coverage of all new members of the group being compulsory. Also, policemen and firemen in all States should be provided the same opportunity for coverage as other State and local government employees.

14. First part of recommendation not enacted.

In 1967 under certain conditions coverage under voluntary agreements between States and the Federal Government was extended to firemen under a retirement system.

1971 ADVISORY COUNCIL ON SOCIAL SECURITY

*Council's recommendation**Action*

A. CASH BENEFITS

GENERAL RECOMMENDATIONS

1. *Automatic Adjustments.*—The law should provide a guarantee that, in the absence of congressional action, social security benefits will be at least kept up to date, automatically, with increases in prices, and that the contribution and benefit base and the retirement test exempt amount will be automatically adjusted to increases in earnings levels.

2. *Criteria for Future Benefit Increases.*—Future congressional consideration of social security cash benefit levels should include consideration of improved benefit levels based on criteria related to (1) the adequacy of benefit amounts for regularly employed low-paid workers and (2) the relationship of benefit levels in general to the levels of living of current workers.

3. *The Contribution and Benefit Base.*—The maximum amount of annual earnings that is taxable and creditable toward benefits—the contribution and benefit base—should be increased to \$12,000 in 1974 and thereafter should be automatically kept up to date with rising earnings levels.

4. *Maximum Family Benefits.*—Each time a general benefit increase takes place in the future, maximum family benefits should be increased by the same percentage so that families coming on the rolls after the general increase occurs, as well as families already on the rolls at the time, would be guaranteed the full amount of the increase.

1. Automatic adjustment of benefits and contribution and benefit base enacted in 1972.

Automatic adjustment of retirement test exempt amount enacted in 1972.

2. Partially adopted. 20-percent benefit increase and special minimum benefit for long-term workers enacted in 1972.

3. Substantially adopted. Under 1972 legislation the base went to \$10,800 in 1973 and \$12,000 in 1974 with automatic adjustment thereafter. (1973 legislation increased base to \$13,200 in 1974.)

4. Enacted in 1971.

RETIREMENT AND SURVIVORS PROTECTION

5. *Lump-Sum Death Payments.*—The statutory dollar limit of \$255 on the lump-sum death payment should be removed so that lump-sum payments would vary with the past earnings of the worker. The payment should continue to equal three times the benefit computed on the earnings of the deceased worker, with the maximum payment being the same as the highest monthly benefit for a family.

5. Not enacted.

*Council's recommendation**Action*

6. *Election to Receive Actuarially Reduced Benefits.*—A person eligible for actuarially reduced benefits both as a retired worker and as a spouse should be able to choose to take only one of the two benefits and claim the other one later, with the reduction in one benefit having no effect on the amount of the benefit that is taken later.

6. Not enacted.

7. *Retroactive Benefit Payments.*—Social security benefits should not be paid retroactively for months before an application is filed when this would require permanent reduction of future monthly benefits.

7. Not enacted.

8. *Equal Treatment of Men and Women.*—The number of years over which earnings are averaged in figuring benefit amounts, and the period used to determine the amount of covered employment needed to qualify for benefits, should be shortened by 3 years for men, so that the number of years used would be the same as for women—both for those on the benefit rolls and for those coming on in the future. Also, actuarially reduced benefits should be provided for dependent widowers at age 60, as they are now for dependent widows.

8. Shortened benefit computation period for men enacted in 1972, but prospective only—not for those men already on the rolls.

Reduced benefits for dependent widowers at age 60 enacted in 1972.

9. *The Retirement Test.*—The social security retirement test, under which benefits are decreased or withheld if a beneficiary has substantial earnings from work, should be retained, but the test should be changed to enable beneficiaries to increase their earnings without disadvantage.

9. Substantially adopted in 1972.

10. *Widows and Widowers.*—Widows' and dependent widowers' benefits should be increased so that a widow or dependent widower who comes on the rolls at or after 65 would receive either 100 percent of the benefit the insured worker was actually receiving at the time of his or her death or, if the insured worker was not receiving benefits, 100 percent of the benefit he would have been eligible for at age 65. Benefits for widows and dependent widowers who come on the rolls between the ages of 60 and 65 should be reduced so that these beneficiaries will receive about the same amount in benefits, over the longer period over which the benefits will be paid, as they would have received if they started to get benefits at or after age 65.

10. Enacted in 1972.

*Council's recommendation**Action*

11. *Child Dependent on a Related Worker Not His Parent.*—Benefits should be provided for a child on the basis of the earnings of a related worker other than his parent if the child was dependent on and living with the worker for a specified period immediately before the worker became entitled to benefits or died.

11. Similar provision adopted in 1972—but applicable only where the "related worker" is the child's grandparent.

12. *Support Requirement for Divorced Wives and Widows.*—The law should be revised to eliminate the requirement that to qualify for benefits based on the earnings record of her former husband a divorced woman must show that she lost support or a potential source of support when he retired, became disabled, or died.

12. Enacted in 1972.

DISABILITY PROTECTION

13. *Insured Status Requirements for Disability Benefits.*—Workers should be able to qualify for disability benefits without having to meet a test of recent covered work—a test that does not have to be met to qualify for other social security benefits.

13. Similar provision adopted in 1972—limited to the blind only.

14. *Waiting Period for Disability Benefits.*—The waiting period for disability insurance benefits should be reduced by 1 month so that benefits would first be payable for the 6th month after total disability occurs (payable in the 7th month), and such benefits should be paid without regard to whether the disability is expected to last at least 12 months or to result in death.

14. Reduction in waiting-period provision adopted in 1972 but 12-month prognosis-duration requirement not changed.

15. *Older Disabled Workers.*—A worker aged 55 or over should be considered disabled for purposes of social security if he meets the test of disability now applicable to older blind workers, which is more liberal than the general test of disability in present law.

15. Not enacted.

16. *Rehabilitation of Disability Beneficiaries.*—The amount of social security trust fund money authorized for reimbursement of State vocational rehabilitation agencies for the costs of rehabilitating social security disability beneficiaries should be increased.

16. The 1972 amendments increased in steps the amount of trust fund money to 1.5 percent of previous year's disability benefits; Council recommended up to 2 percent.

*Council's recommendation**Action*

17. *Workmen's Compensation Offset for Disability Insurance Beneficiaries.*—When a disabled worker is eligible for both social security disability benefits and workmen's compensation, his combined benefits should be restricted to an amount that is less than he was earning before he became disabled. However, the method prescribed in present law for determining a disabled worker's previous earnings—based on average earnings over a period of 5 years or more—should be revised to provide a more accurate measure of the worker's earnings at the time he became disabled. Such a measure would be provided by his earnings in his best year in the period consisting of the year in which he became disabled and the five years immediately preceding that year.

17. Enacted in 1972.

18. *Disabled Widows and Widowers.*—Disabled widows and disabled dependent widowers should be eligible for benefits without regard to age, and the benefits should not be reduced by reason of their beginning before age 65.

18. Not enacted.

19. *Disabled Wives and Husbands.*—Benefits comparable to those provided for aged wives and aged dependent husbands of social security beneficiaries should be paid to disabled wives and disabled dependent husbands.

19. Not enacted.

20. *Childhood Disability.*—The disability benefits provided for sons and daughters of insured deceased, disabled, or retired workers who become totally disabled before reaching age 18 should be provided also for those who become totally disabled after reaching age 18 but before age 22. Also, a person whose childhood disability benefits are terminated because he returns to work or recovers temporarily should be permitted to again be eligible for benefits if he becomes unable to work before he has had a reasonable opportunity to acquire disability protection based on his own earnings.

20. Enacted in 1972, except that reentitlement period is 7 years, while Council recommended 10 years.

COVERAGE UNDER SOCIAL SECURITY

21. *Federal Civilian Employees.*—The Council recommends that the Congress give consideration to an approach under which earnings credits under social security and the civil service retirement system of a worker who retires, becomes disabled, or dies, would be combined in cases when there is no benefit eligibility under one or either system so that benefits can be paid—under one system or the other—which

21. Not enacted.

*Council's recommendation**Action*

22. *Farm Workers*.—Social security coverage of farm workers should be improved by providing that employers who have substantial amounts of expenditures for farm labor report all of the cash wages paid to their employees, and that the determination of whether leaders of farm labor crews are employers of their crew members be made under the common-law test of whether an individual is an employee.

22. Not enacted.

B. MEDICARE

1. *Coverage for the Disabled*.—Medicare should be extended to social security disability beneficiaries.

1. Enacted in 1972, but limited to persons who have been receiving benefits on the basis of their disability for 24 consecutive months.

2. *Coverage of Prescription Drugs*.—Medicare should be expanded to include coverage of out-of-hospital drugs requiring a prescription. Such coverage should apply to all persons entitled to Medicare protection, including social security disability beneficiaries as well as those age 65 and over. Medicare should be responsible for a flat copayment amount of \$2 per new prescription and \$1 per refill prescription, and the Medicare payment should be to the drug vendor, who would be responsible for maintaining necessary records and initiating claims.

2. Not enacted.

3. *Financing Hospital Insurance and Supplementary Medical Insurance through Social Security Contributions and General Revenues*.—For financing purposes, supplementary medical insurance (now financed through premiums and general revenues) should be combined with hospital insurance, and the Medicare program, as enlarged under the Council's recommendations, should be financed by one-third contribution from employees, one-third from employers, and one-third from general revenues. Thus, people would pay in advance toward supplementary medical insurance, as they do toward hospital insurance, through contributions during the working years rather than premiums after age 65.

3. Not enacted. Under 1972 amendments, supplementary medical insurance premium can be increased only in event of a general benefit increase—and then by no more than the percentage by which cash benefits have been increased since the SMI premium was last increased.

4. *Coverage of Additional Days of Inhospital Care and Extended Care*.—The number of "lifetime reserve" days for which inpatient hospital benefits may be paid should be increased from 60 days to 120 days, and the daily rate of coinsurance now applicable to such lifetime reserve days should be an amount equal to one-fourth (rather

4. Not enacted.

*Council's recommendation**Action*

than the present one-half) of the inpatient hospital deductible. A lifetime reserve of 60 covered days, to which would be applied a rate of coinsurance equal to one-eighth of the inpatient hospital deductible, should be added to the present posthospital extended care benefits.

C. FINANCING

ACTUARIAL SOUNDNESS OF THE PROGRAM

1. *Current Status.*—Adequate provision has been made in the law to meet all the costs of the cash benefits program both in the short run and over the long-range future; the cash benefits program is actuarially sound. Income to the supplementary medical insurance part of the Medicare program will be more than sufficient to meet incurred benefits costs over the period, established by the law, for which monthly premiums have been promulgated. However, unless income is increased, the hospital insurance trust fund will be exhausted in 1973.

1. Under estimates made at the time of the 1973 legislation, the cash-benefits program remains actuarially sound. The underfinancing of hospital insurance program was corrected in 1972 and that part of the program is actuarially sound.

MANAGEMENT AND INVESTMENT OF THE TRUST FUNDS

2. *Investment Policy.*—The Managing Trustee of the social security trust funds should adopt a policy of investing in special obligations with maturity dates equal to the maximum maturity date of Treasury notes (at present 7 years) rather than maturity dates of 15 years from date of purchase.

2. Adopted. No legislation necessary.

3. *Interest-Rate Formula.*—The interest rates on special obligations issued to the trust funds should be equal to the average market yield on all marketable Treasury notes that are not due or callable until 4 or more years from the time the special obligations are issued.

3. Not adopted; under study by Boards of Trustees.

4. *Securities Issued by Federally Sponsored Agencies.*—The Council believes that there is adequate statutory authority for investment of trust fund money in securities issued by federally sponsored agencies. The Council recommends that the Managing Trustee establish a policy of purchasing a portion of new obligations issued by such agencies as investments for the trust funds.

4. Not adopted; under study by Boards of Trustees.

*Council's recommendation**Action*

5. *Boards of Trustees.*—The Council recommends that two nongovernment members, to be appointed by the President subject to confirmation by the Senate, be added to the boards of trustees of the social security trust funds.

5. Requires legislation. Not enacted.

6. *The Trust Funds and the Unified Budget.*—Even though the operations of the social security trust funds and other Federal trust fund programs are combined with the general operations of the Federal Government in the unified Federal budget, policy decisions affecting the social security program should be based on the objectives of the program rather than on any effect that such decisions might have on the Federal budget. The operations of the social security and other Federal trust funds should continue to be identified as such and separated from the general operations of the Government.

6. This recommendation has generally been followed.

ACTUARIAL ASSUMPTIONS AND METHODOLOGY

7. *Earnings Assumption.*—The Council recommends that the actuarial cost estimates for the cash benefits program be based—as the estimates for the hospital insurance program now are—on the assumptions that earnings levels will rise, that the contribution and benefit base will be increased as earnings levels rise, and that benefit payments will be increased as prices rise.

7. Adopted in 1972; no legislation necessary.

8. *Single Best Estimate.*—Contribution rates should be based on a single, best estimate derived from a single set of assumptions that reflect likely future trends in the factors that affect income and outgo of the program, rather than on an average of a low-cost and a high-cost estimate, as has been the case in the past; and there should be a series of estimates which show the extent to which the best estimate might vary if experience with respect to any of the major factors were to differ from the assumptions.

8. Being adopted gradually, no legislation necessary.

9. *Valuation Period for Health Insurance.*—The Council recommends that the valuation period for estimating health insurance program costs be reduced from 25 years to 10 years.

9. Not adopted.

*Council's recommendation**Action*

THE SIZE AND FUNCTION OF THE TRUST FUNDS

10. *Current-Cost Financing.*—The financing of the program should be on a current-cost basis, with the trust funds maintained at a level approximately equal to one year's expenditures.

10. Reflected in 1972 and subsequent legislation.

GENERAL REVENUE FINANCING OF MEDICARE

11. *Gradual Increase in General Revenue Financing of Medicare.*—The combined Medicare program should be financed with a general-revenue contribution equal to one-third of total program costs, with such share being lower than one-third at first and gradually increasing over a period of years to the one-third level.

11. Not enacted. (See Recommendation B., 3)

CONTRIBUTION RATES FOR CASH BENEFITS AND MEDICARE

12. *Contribution Rates.*—The Council believes that the contribution rate schedule for the next 10 years should be designed to follow closely the principle of current-cost financing described in Part IV. Contribution rates for the cash benefits program after the next 10 years would be shown in two steps, each based on average rates for an extended period of several decades. Contribution rates for the Medicare program would not extend beyond a 10-year period since the Council does not believe that it is feasible to make realistic estimates for this program for a longer period.

12. Recommendation with regard to cash benefits program reflected in 1972 legislation.

See 9 above with regard to valuation period for hospital insurance program.

GLOSSARY

Annual exempt amount.—Amount of earnings a beneficiary can have in a year and still receive all of his benefits for that year (\$2,520 for the year 1975). (The amount is automatically adjusted periodically based on increases in general earnings levels.)

Average covered wages.—The measure used to determine increases in the contribution and benefit base and the retirement test exempt amount. Average covered wages, for this purpose, are the average amount, per employee, of the taxable wages of all employees reported under the program for the first calendar quarter of a given year. (As used in the report, "wages" refer to cash remuneration for employees, including wages, salaries, etc., as compared to "earnings" which denote wages plus self-employment income.)

Average monthly earnings (AME).—The earnings used to determine the primary insurance amount on which benefits for a worker and his family will be based. In general, average monthly earnings are computed by averaging the worker's total earnings (limited to the contribution and benefit base in any year) over 5 years less than the number of years elapsing after 1950, or age 21, if later, and up to the year of death, disability, or the year in which the worker reaches retirement age.

Average monthly indexed earnings (AMIE).—Same as AME, except that the earnings in each of the years included in the averaging period would be updated when a worker retires, becomes disabled, or dies to take account of the increase in average covered wages since the years in which the earnings occurred.

Consumer price index (CPI).—The index published monthly by the Bureau of Labor Statistics of the Department of Labor, which is used to measure average changes in prices of goods and services usually bought by urban wage earners and clerical workers. The social security law provides for automatic increases in benefits to take account of increases in the CPI. The first such increase will be effective for June 1975.

Contribution and benefit base.—The maximum amount of a worker's annual earnings on which social security contributions are paid and which is counted in figuring social security benefit amounts. In 1975, the base is \$14,100 and will automatically increase in the future as average covered wages of all employees increase.

Covered earnings.—The amount of a worker's earnings in employment or self-employment that is covered under the social security program up to the amount of the contribution and benefit base for a given year.

Disability insurance benefit.—The social security benefit payable to a disabled-worker beneficiary based on his or her covered earnings.

Earnings test.—See "retirement test."

Old-age insurance benefit.—The social security benefit payable to a retired-worker beneficiary based on his or her covered earnings.

OASDI.—Old-age, survivors, and disability insurance; the cash benefits portion of the social security program.

Percent of taxable payroll.—The long-range cost of the social security program or of changes therein expressed as a proportion of the average of all covered earnings over the 75-year valuation period for which cost estimates are made. (This concept is discussed in further detail on page 94 in the report of the Subcommittee on Finance.)

Primary benefit.—The social security benefit based on a worker's covered earnings that is payable to the worker; an old-age or disability insurance benefit.

Primary insurance amount (PIA).—The amount on which all earnings-related social security benefits are based. A worker's PIA is derived from his average monthly earnings under social security. A worker's disability benefit or his old-age benefit at age 65 is equal to 100 percent of his PIA. Eligible dependents and survivors get benefits equal to various percentages of the worker's PIA.

Replacement rate (also, "replacement ratio").—The percentage of a worker's earnings in the year prior to becoming a beneficiary that are replaced by his social security benefit. Other measures of recent preretirement earnings could, of course, be used but, for uniformity and convenience, the year before entitlement is used in this report.

Retirement test.—The provision in the social security law under which some or all benefits are withheld if a person has earnings in a year that exceed a specified amount (\$2,520 for 1975). (The amount is automatically adjusted periodically based on increases in general earnings levels.)

Secondary benefit.—A benefit based on a worker's covered earnings that is payable to a member of his family; a social security benefit payable to a person based on someone else's covered earnings.

Taxable payroll.—Total amount of wages and self-employment income, up to the contribution and benefit base for each worker, that is subject to social security contributions.

Total earnings in covered employment.—The combined total of all earnings of employees and the self-employed in work covered by the social security program in a given year without regard to the prevailing contribution and benefit base.

Mr. BURKE. On behalf of the committee we wish to thank the panel for their appearance and their contribution here today.

Mr. WALLIS. Thank you very much.

Mr. VAN GORKOM. Thank you.

Mr. BURKE. The committee now stands adjourned and will meet tomorrow at 2 p.m.

We will have economists and actuaries to discuss social security problems.

We stand adjourned.

[Whereupon, at 4:10 p.m. the subcommittee adjourned, to reconvene at 2 p.m., Thursday, May 15, 1975.]

FINANCING THE SOCIAL SECURITY SYSTEM

THURSDAY, MAY 15, 1975

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The subcommittee met at 2 p.m., pursuant to notice, in room H-208, the Capitol, Hon. James A. Burke (chairman of the subcommittee) presiding.

Mr. BURKE. The subcommittee will be in order.

Today the subcommittee will hear the views of a distinguished panel of actuaries and economists and an expert in population matters. I believe the viewpoints that will be expressed today will be most interesting and informative to the members. I expect there will be some differences of opinion expressed.

After having looked over the statements of the panelists I believe it might be helpful for development of the issues to make a slight modification in the order in which the panelists will make their statements. Mr. Myers, who is listed as the first panelist, has a statement which deals with very specific and somewhat technical matters. I think it might be more appropriate, therefore, to have Mr. Myers present his statement after the other panelists have made theirs.

PANEL CONSISTING OF GEOFFREY N. CALVERT, ACTUARY AND EMPLOYEE BENEFIT CONSULTANT, POMENSON/ALEXANDER LTD., VANCOUVER, BRITISH COLUMBIA; HOWARD YOUNG, ACTUARY, UNITED AUTO WORKERS, WASHINGTON, D.C.; JOHN A. BRITTAIN, ECONOMIST, BROOKINGS INSTITUTION; MARTIN FELDSTEIN, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY; CONRAD TAEUBER, GEORGETOWN UNIVERSITY, DIRECTOR OF CENTER FOR POPULATION RESEARCH; ROBERT MYERS, PROFESSOR, ACTUARIAL SCIENCE, TEMPLE UNIVERSITY (FORMER CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION)

Mr. BURKE. Our first panelist will be Geoffrey Calvert. We will recognize Mr. Calvert for the record.

You can sit down and present your statement, sir.

STATEMENT OF GEOFFREY N. CALVERT

Mr. CALVERT. Mr. Chairman, committee members, among the steps needed to restore the social security system to a sound financial condition, first priority must be given to the redesign of the basic

benefit formula, so that it will no longer respond irrationally to changes in the economy. If this step is not taken, then the entire system will go further and further out of control.

In the 1974 Report of the Trustees it was shown that in order to sustain the system on a sound basis in the long run, the tax rate would have to be raised by 2.98 percent of payroll, or by about 27 percent of the tax rate currently enacted in the law, or other equivalent steps taken.

In the 1975 Report of the Trustees just released, a still greater deficiency is indicated. Instead of 2.98 percent of payroll, it is now 5.32 percent of payroll. Instead of a 27-percent increase it is now about a 48-percent increase in revenues that is called for over the long run.

It is very good to get these facts out into the light. They do reveal a most serious situation. But there are strong reasons for thinking that, unless the existing technical flaw in the basic benefit formula is corrected, the actual outlook will be even worse than that which has been revealed so far. In other words, the financial condition of the system will continue to deteriorate.

The reasons for this are twofold:

First, the present, that is, 1975, projections are based on a somewhat optimistic assumption that the rate of increase in real wages will, over the long run, average 2 percent annually.

The present system is extremely sensitive to changes in this figure. If the actual increase in real wages is even slightly less, then costs will rise. (Recent experience has been not only less than 2 percent, but negative.)

Present evidence indicates that the assumed 2 percent is at the top end of the range of reasonable estimates, and that a somewhat lower figure may be more realistic. This would result in a greater deficiency than 5.32 percent of payroll.

Second, it has been further assumed that the rate of increase in the CPI—often called the rate of inflation—will level out at 4 percent annually—far below today's levels.

This is another economic factor to which the present system is hypersensitive.

It is of course to be hoped that these economic assumptions can and will be realized in the future. But when one considers the enormous problems we face in developing substitute forms of energy, the tightening outlook for food in the world, the added costs from pollution and environmental factors, the outlook for raw materials on a worldwide basis, and the rising costs of a welfare state, the probability that this 4 percent rate will actually be realized in the long run may not be very good.

Now let us see what will happen under the present system if either of these misgivings proves to be justified.

First, a failure of only one-half of 1 percent in the rate of increase in real wages to measure up to the assumption, will unbalance the long-term finances of the system by a further 2.33 percent of payroll.

Second, an inflation rate of 6 percent in place of the assumed 4 percent would similarly unbalance the whole system to the extent of about 2.93 percent of payroll.

There is thus an "area of unpredictability" which could easily double the presently indicated deficit of 5.3 percent of payroll.

Now suppose the advance in real wages in the future—after overcoming all of the problems presented by the energy situation, world population growth and hence struggle for food, resource depletion, the swing from cash wages to fringe benefits, earlier retirements, environmentalism, the costs of the welfare state, and similar factors—were to average 1 percent instead of the 2 percent (or less) as indicated by the record of the past.

Then in this case the tax rates would have to advance as follows, depending on the rate of inflation. Now, we have here a table showing the necessary tax rate in each point of time—1990, 2010, 2030, 2045—and these figures are percentages of payroll. Those should have a percent sign after them. These are the percent of payroll figures, and as you can see they rise up in the future all the way up to 27 percent, 32 percent, 38 percent, and 43 percent of payroll.

These figures are projected by the Social Security Actuary's Office in Baltimore, and do reflect the cost of the system on the basis of 1 percent growth in real wages.

The chart on the next page of the prepared statement shows the advance in tax rate, starting from where we are now, a little over 10 percent, and going way up into unthinkable areas in the long run. These taxes will result if the system is just let to run as it now is.

At the same time as these unthinkable tax rates were emerging, benefits would be skyrocketing out of all reason, with replacement ratios, that is, ratio of primary retirement income to gross wages while working, crashing up through 100 percent of gross earnings, and advancing in some cases even above 200 percent of gross pay while working, and even higher percentages of net take-home pay.

When the spouse's benefit is added, and it is remembered that these benefits are indexed and tax-free, the absurd results which can easily come from the present system can be seen. Long before this stage could be reached, there would of course be an overturning of the whole system, but vast damage would have been done.

To gain a further insight into the irrational behavior of the present benefit formula, let us suppose that wages grow at 5 percent annually, but that the CPI (the cost-of-living, or Consumer Price Index) grows at 2 percent, 3 percent, or 4 percent annually. In these circumstances, the replacement ratios for a low-paid worker would be as indicated in this table [on page 5 of the prepared statement].

Now, we see if the inflation rate is 2 percent, the replacement ratio, that is, the ratio of benefits to earnings, goes down and down, so that eventually instead of 60 percent of earnings the low-paid employee would retire with 44 percent of earnings. Now, that is an economy that is doing very well.

If we look at the 4 percent column, instead of 61 percent of earnings at retirement, the figure grows and grows to 164.7 percent of earnings.

If the economy does well, the worker does progressively more poorly. If the economy does poorly, the worker does better and better. The costs of the system as a whole will of course reflect this absurd result. And this is the system we now have, this is how it works.

But the important thing to recognize is not the question of validity of these or any other actuarial or economic assumptions but the wholly unnecessary vulnerability of the social security system to them.

There is no need for the costs and benefits under this system to magnify the slightest changes in these economic factors or to swing widely up or down, depending on the fickle, fluctuating interrelationship between unpredictable economic factors often dictated from outside this country.

Many comments have been made in recent reports of expert panels as to the difficulty of estimating the costs of the present system. As an actuary and an economist, I would say that there is no valid way of predicting either the costs or the benefit results which will emerge from the present system. Both are far too sensitive and vulnerable to unpredictable influences.

A revised benefit formula would get rid of this trouble, which has arisen accidentally in the drafting of the primary income benefit formula. Unintentionally, it has been over-indexed. There is no good reason why this error should not be corrected. Nor is there any reason to delay this action, since delay means more drift and more financial strain.

Several suitable alternative formulas have been put forward, any one of which would remove this trouble. The formula set forth in the report of the Advisory Council on page 67 is one such example of a suitable replacement formula which would stabilize the relationship between earnings before retirement and benefits after retirement.

This, then, is the first thing that needs to be accomplished. That is the so-called decoupling of that formula. That is absolutely essential and needed.

There are other measures which need to be implemented and which may take longer to accomplish or have a bit less urgency. These include:

(1) Early steps to protect the trust fund from erosion and disappearance.

(2) Universal coverage of the system, to put a stop to abuses of the system now practiced by certain groups.

(3) In view of the vast and urgent need of the U.S. economy for new capital formation to finance alternative energy sources, raw materials, industrial plant and equipment, urban transportation systems, and similar strengthening, amounting in all to \$4.1 trillion by 1985, according to a recent estimate—of which only \$2.6 trillion is in sight, leaving \$1.5 trillion still to be found—consideration might well be given to the placing of the funding of the social security system on a regular actuarially funded basis.

At the cost of an increase in taxes in the short term, this would protect the system from a 50-percent surge of cost in the early part of the next century, when the vast demographic bulge of survivors from the high birth rates of the frantic fifties and the soaring sixties reach retirement age, while the work force then providing the taxes to support them will be the survivors of the greatly shrunken birth rates of these more recent years.

It has been estimated that the amount needed to place the whole system on a funded basis would be between \$1 trillion and \$2 trillion. This is in about the same order of magnitude as the amount needed to strengthen the economy and insure that the productivity will be there to provide the benefits expected by today's work force when their time of retirement approaches.

Apart from leveling out the costs of the system over the coming decades, this approach would lower the long-term cost burden, since the investment yield of the fund would make a very substantial contribution toward meeting the rising cost of benefits, such as, for example, 40 percent or more of these costs.

In order that this approach should be effective in accomplishing the basic purpose of strengthening the economy, safeguards would be needed to prevent a diversion and dissipation of these funds into current consumption. At the same time steps may be needed to avoid the hazards of an overwhelming concentration of economic power in one place.

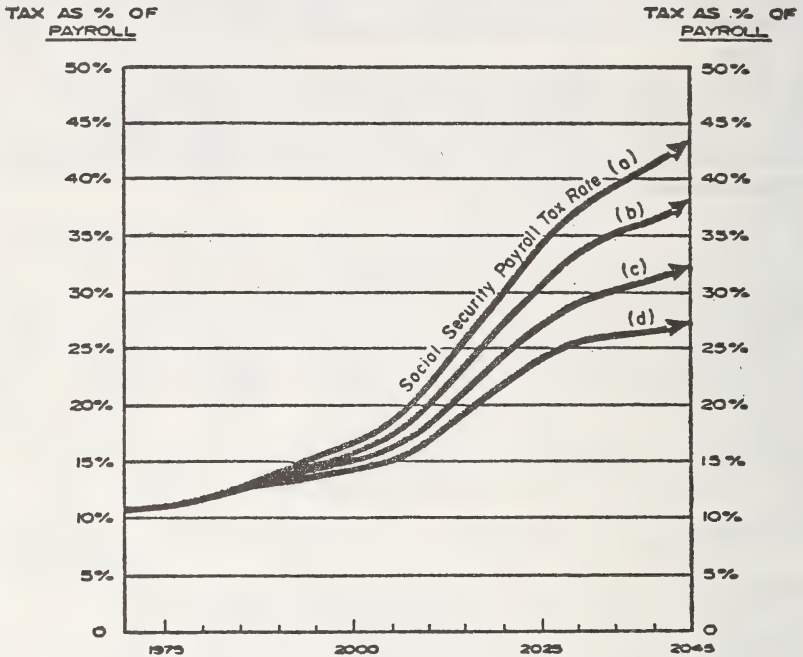
If both of these problems can be overcome—and they should—this approach would provide America with a great opportunity to accomplish two fundamental goals at the same time: a strengthening of the sinews of our economy, and a resolution of the problems of financing the social security system.

[The chart and tables follow:]

RATE OF GROWTH IN CPI

Year	3 percent	4 percent	5 percent	6 percent
1990	13.16	13.39	13.76	13.96
2010	16.69	18.09	19.87	21.32
2030	25.53	29.11	33.48	37.47
2045	27.22	32.21	38.11	43.33

IMPACT OF INFLATION ON PAYROLL TAX RATES
NEEDED TO SUPPORT (OASDI) BENEFITS
UNDER AUTOMATED SOCIAL SECURITY SYSTEM



Curve (a) Shows Tax Rates if Wages Advance at 7 % , Prices at 6 % Annually.

(b) Shows Tax Rates if Wages Advance at 6 % , Prices at 5 % Annually.

(c) Shows Tax Rates if Wages Advance at 5 % , Prices at 4 % Annually.

(d) Shows Tax Rates if Wages Advance at 4 % , Prices at 3 % Annually.

CPI GROWTH RATE

Year of retirement	Percent		
	2	3	4
1975.....	60.6	61.1	61.5
1985.....	54.7	60.8	67.5
2000.....	51.1	65.7	84.3
2025.....	48.9	79.9	129.9
2050.....	44.5	85.5	164.7

Mr. BURKE. Thank you, Mr. Calvert. We will now hear from Howard Young.

STATEMENT OF HOWARD YOUNG

Mr. YOUNG. Mr. Chairman, I appreciate the opportunity to participate at this stage of the committee's consideration of OASDI and its financing.

In view of the erroneous interpretations that have appeared in many articles and the apprehensions they have caused, it is essential to start out by noting that there is no reason to doubt that social security benefits will be paid each month, that the Nation has the resources and productive capacity to support our senior citizens, and that the lack of advance funding does not reduce the actuarial soundness of the program.

Those who criticize the program because it does not use procedures that are necessary for an insurance company, or an employer-sponsored pension plan, simply do not understand—or do not wish to recognize—the different considerations that apply to a national compulsory program.

Noting that the program is viable and functioning is not inconsistent with a recognition that legislative action will be needed to improve various aspects of the program. A wide range of alternatives for such action is available.

While technical analysis is important to rule out unsound approaches, there will be need for public policy judgments in order to choose from alternatives that are technically satisfactory.

I understand that the committee will be holding future hearings to obtain such public policy input, and the UAW would like to participate in that. My statement today does not attempt to deal with many of those considerations but instead is limited to certain aspects of the projected deficit in the OASI portion of the program.

With respect to the short-term prospects, as set out in the 1975 Report of the Trustees, it seems to me that the significance of the unemployment assumptions has not been adequately emphasized.

The short-term projections of the trust fund operations cover the years 1975–1979, and average annual unemployment during those years is assumed to decline from 8.8 percent during 1975 to 5.4 percent during 1979. Whether or not such high rates of unemployment will actually be experienced will depend on Government actions aimed specifically at that problem, as well as on other factors.

What the trust fund projections illustrate is one implication of high unemployment: the loss of payroll taxes that would otherwise be paid into the trust fund. The additional taxes that would be

contributed at higher employment levels depend on many factors, but an outside figure can be obtained by calculating pro-rata amounts from the contributions (less refunds) data shown in table 11 of the trustees report.

These figures are shown below, along with the trustees' projections of the decrease in the OASI Trust Fund. What I show are for each of the years an outside figure—and I emphasize, it is an outside figure—a tax loss compared with a decrease in the fund, and in each case the tax loss is larger.

[The table follows:]

[In billions]

Calendar year	Potential taxes for the unemployed ¹	Decrease in fund
1975 -----	\$5.4	\$2.2
1976 -----	5.3	4.3
1977 -----	5.3	4.0
1978 -----	5.2	4.3
1979 -----	4.9	4.8

¹ Contributions (per table 11) × (unemployment rate ÷ (100 — unemployment rate)).

Mr. YOUNG. While this calculation is not intended to argue that employment will be high enough to prevent the trust fund from decreasing, it does indicate that any significant reduction in unemployment could produce a substantial reduction in the projected annual decreases.

To put the point another way, one purpose of the trust fund is to absorb unusual fluctuations in income or outgo. Hence, to the extent that the projected decreases in the trust fund are attributable to high unemployment levels, they are not an indication of problems in the social security program; instead, they reflect the problems of high unemployment.

Obviously, decreases in the trust fund cannot continue indefinitely. Nevertheless, it is completely sound for it to act as a buffer for temporarily unsatisfactory conditions in the general economy, and for the Congress to deal with those conditions rather than to take action aimed at increasing the trust fund in spite of those conditions.

Although not directly related to financing, it should be noted that another effect of unemployment is the impact it will have on future benefit determinations of those who are unemployed. The loss of covered earnings will have a particularly adverse effect on those who are near retirement age.

The longer range issues are more significant because they reflect some technical deficiencies in the benefit formula, as well as demographic and social trends which will affect most of the Nation's institutions, including Social Security.

As a member of the group of actuarial and economic consultants to the recent advisory council, I participated in the development of a proposal to revise the benefits formula. Since I believe that the details of that have already been given to the committee, it should be sufficient to indicate here that the problem with the present benefit formula is that it reflects several factors which are independently determined and which, in combination, may or may not produce a satisfactory result.

The essential element of the new approach which we proposed—and which Bob Myers will speak to in more detail, I see—would be to establish a procedure (indexing) which would directly apply to each individual's actual wage history, the annual changes in national wage levels.

At this point, I want to emphasize certain aspects of the mechanics of implementing the indexing procedure if the Congress agrees to adopt that approach.

Indexing can be applied to any level of benefits. In developing our proposal, the consultants to the advisory council made it clear that we were not dealing with the issue of whether the present ratio (replacement ratio) of benefits to earnings, at time of retirement, is satisfactory. Our use of a formula which could reproduce the current replacement ratio was merely illustrative, a formula could just as easily be determined which would produce any other desired level of replacement ratio.

The indexing proposal is a reaction to a development which is predictable, but will not become significant in the near future. For example, appendix table D of the trustees report shows the projected trend of replacement ratios if the present benefit formula is continued.

For the period 1985–95, the replacement ratio for new benefit awards is projected at 6 percent to 7.4 percent higher than the current ratio; it is only in subsequent years that the projected replacement ratio increases substantially: about 12.6 percent higher than at present by the year 2000, and 47.3 percent higher than at present by 2050.

Thus, while I believe that immediate attention should be given to the development of an indexed benefit formula, there is time to do a full review of all the considerations that need to be taken into account in establishing the new formula, and to provide sufficient lead time—after enactment and before the formula actually becomes effective—so that this fundamental change in method of benefit calculation can be implemented.

In connection with the latter requirement, there will not only be the need to fully acquaint Social Security Administration personnel with a new approach, but also to deal with the public confusion that will undoubtedly occur.

For a change of this nature, lead time might be thought of in terms of years rather than months. The value of substantial lead time is all the more reason to undertake and complete the decisionmaking process in the near future.

This proposal for decoupling—that is, separating the method of calculating initial benefit awards from the procedure for calculating subsequent adjustments for those already collecting benefits—through indexing is motivated by the problems with the present formula for calculating initial benefit awards.

It would be necessary to have an appropriate procedure to smoothly merge the indexing procedure, with the present cost-of-living adjustments for benefits already being paid. Such a procedure was developed, although not included in the Advisory Council Report.

However, in the past Congress has provided increases greater than needed to offset changes in the cost of living, and thus permitted beneficiaries to share in the real growth of the economy, but has not chosen to provide any such increases on an automatic basis.

Without attempting to argue now whether or not changes in the wage level—rather than in cost of living—should be used as the basis for automatic adjustment of benefits already in payment status, it should be recognized that it would be feasible to do that. This is another aspect that should be fully explored in considering revisions to the method of calculating benefits.

The development which requires the most serious and far-reaching consideration is the demographic trend. If the population composition changes as indicated by the projections in the trustees report—they seem reasonable, but it must be noted that there has not been a record of successfully predicting long-range population data—it will have major implications for most of the Nation's institutions, not just Social Security.

One illustration of this is given by the data in appendix table A of the trustees' report. In addition to the estimated number of people in various age categories, that table shows that the ratio of those 65 and over, as compared with those age 20–64, as increasing from 18.9 percent in 1985 to 28.4 percent in 2050; while not shown in that table, the corresponding ratio currently is about 18.8 percent. The clear implication is that the working-age population will be called upon to support proportionately more retirees in the future.

However, the table does not explicitly show that the situation is quite different when all persons not in the working age group are considered. That is, the ratio of those age 65 and over plus those under age 20, as compared with those age 20–64. Based on the data in that table A, that ratio would increase from 68.9 percent in 1985 to 77 percent in 2050; however, it is currently approximately 83.1 percent.

Thus, the total burden of those who are supported by the working age population is expected to be considerably less in the future than now.

The essential point is that examining only the OASI aspects—for example, the cost of supporting retirees—of the long-range population trends gives an insufficient picture. This is particularly true because the Social Security system translates benefits for retirees into a payroll tax cost, while many of the expenditures for the preworking age group are financed in other ways.

The use of general revenue funds to supplement payroll tax financing of Social Security has been suggested on many occasions; the projected population trends provide another reason to make that change in financing.

The question of female participation in the work force is closely related to the demographic trends. Fewer children, and a deemphasis of employment differentiation by sex, both indicate higher employment levels for women, and the trustees have made some allowance for that in their assumptions.

One aspect of this is that the increase in the ratio of those who are dependent, to those who are employed, will be less than was indicated above because the data above used the population at ages 20–64 without estimating those actually employed.

Increased employment of women has perhaps even more important implications for the family benefit structure of Social Security. There has been growing concern with the benefit amount or eligibility

differentials that are based on sex. However, the more significant of these—for example, benefits for a retiree's wife—derive from the concept of a male wage-earner who supports other nonworking family members.

Increasing employment of women, and other changes in family structure, indicate the need to thoroughly review the benefit structure.

The points made in this paper can be summarized as follows:

One: There is no reason for social security beneficiaries to be concerned about receiving their payments.

Two: A major cause of the projected short-term decreases in the OASI trust fund is the assumed high unemployment level. The purpose of the trust fund is to meet such contingencies, and thus the decrease is not a matter for alarm. The real concern—and focus of remedial action—should be the unemployment level.

Three: The benefit formula is unstable—especially over the long term—and makes it difficult to project benefit levels and costs. An improved benefit formula can be developed by indexing to changes in wage levels. Such a formula could go into effect several years from now, but development should be started now in order to permit a thorough analysis of the issues involved and to permit adequate time to explain and implement the new approach.

Four: Long-term demographic trends indicate that there will be a significant increase in the portion of the population age 65 and over, but this will be offset by the decrease in population below age 20.

One implication of this change in those portions of the population is to further support the case for general revenue supplementation of OASI payroll taxes.

Five: The increasing employment of women, and changes in family structure, indicate the need for a thorough review of the benefit structure.

Six: One final point not previously mentioned is that anticipated real income levels in the future will be substantially higher than now. The economy will be capable of supporting the projected levels of retirees. An improved social security program will provide the mechanism to implement that capability.

Thank you very much.

Mr. BURKE. Thank you, Mr. Young.

Our next witness is Mr. John Brittain, Brookings Institution.

STATEMENT OF JOHN A. BRITTAIN, BROOKINGS INSTITUTION

Mr. BRITTAIN. Thank you.

I am grateful for the opportunity to participate in this panel.

The payroll tax for social security imposes an unfair and soaring burden on our working population. It can easily be reformed and at least partially replaced by a more equitable means of financing. The maximum combined employer-employee tax has grown from \$60 in 1949 to \$1,650 this year—\$3,300 for a two-earner family. A proposal to increase the taxable ceiling to \$24,000 has also been under consideration; this would raise the maximum tax by another 70 percent.

The social security tax on employees is heavier than it looks. A strong case can be made that the tax is ultimately borne entirely by labor—even the part nominally paid by employers. In the long run,

increases in the social security tax on employers will reduce by about the same amount the real basic wages they can afford to offer for labor of a given quality. Employers tend to shift the real burden to labor by restraining wage increases and marking up product prices. This point is elaborated in my more detailed written statement.

These involuntary contributions for social security are also plainly regressive; an individual earning \$141,000 is taxed at one-tenth the rate applied to those below the \$14,100 ceiling. But the harshest feature of all is the lack of personal exemptions for low incomes. The working poor are generally exempt from the income tax. However, they are taxed by social security from the first dollar of their earnings. This problem has been partially alleviated by the earned income credit under the 1975 income tax legislation, but only for earners with children. A more general system of personal exemptions is called for along with other reforms—all to be financed from general revenues, especially proceeds from the income tax.

It may seem utopian to call now for trimming the social security tax when doubts are being raised about the financial credibility of the system. The air is filled with alarmist forecasts of mounting revenue requirements and the impending insolvency of the program. Some writers have already proclaimed social security bankrupt. These doomsday predictions must be disposed of before payroll tax reform can get a hearing. Social security is backed by the most solid source of funds known—the Federal taxing power. The bankruptcy charge is a fantasy and a senseless generator of fear among participants and beneficiaries.

Solvency is not the issue. The real issues are the level of benefits to be promised, and how they are to be financed. The most startling projected deficits are not due to immutable forces. They arise primarily from defective 1972 legislation that would tend to escalate benefits far more rapidly than earnings of the active population. The true issues have been obscured by a tendency to assume that this 1972 benefit formula is with us for all time. I am glad to see today that this panel makes no such assumption.

The current benefit formula would not stand the first serious test, and it should be eliminated quickly—before that test comes. Once a realistic future benefit structure is established, the solvency uproar will subside and the discussion can return to how, rather than whether, benefits will be financed.

What is all the clamor about? It is true that substantial long-run deficits loom under present policy. However, the projected rapid increase in the retired population plays a minor role in this compared to the benefit escalator. This provision in the 1972 law seeks to protect participants against inflation, but it calls for excessive adjustments of scheduled benefits for workers not yet retired. The more rapid the inflation, the more acute would be the symptoms of this malady. Even if rates of inflation are reduced to the 4- to 5-percent level, benefits for many 20th century retirees could exceed the highest wage they ever earned. The taxes required would be intolerable; yet the costs of such unrealistic benefits are included in long-run estimates and are the main source of concern about financing.

The problem of the benefit formula is an unusual and pleasing one, because it is readily soluble. It is due to an irrational double adjustment of benefits to offset inflation. Under the 1972 law the factors used

to convert prior money wages to benefits upon retirement are indexed to keep pace with the cost of living. However, money wages also tend to rise along with the cost of living. The adjustment of the benefit factors, therefore, is largely redundant and would lead to unrealistic benefit levels in the event of rapid inflation.

Future benefits should indeed grow as the economy grows and be protected against inflation. The Advisory Council has presented a logical and practical proposal to achieve this by a simple change in the present law. It would adjust past earnings, rather than conversion ratios, to allow for earnings growth before computing initial retirement benefits. Then benefits would, as now, be indexed by the CPI. This alternative to the present irrational scheme would take account of productivity gains and protect against inflation. Congress need only amend the 1972 legislation in this way to assure that real benefits maintain a desired and feasible relationship with the real earnings base from which they must be paid.

The stabilization of real benefits relative to the individual's adjusted wage history would eliminate the most frightening aspect of current social security projections. The relative increase in the retired population would remain a problem, but studies have shown that this would require an increase of no more than a few percentage points in the tax rate. I have referred to a recent Brookings study of this question in my detailed statement on that subject. It shows that even this increase in the tax rate may not be necessary.

Social security's demographic problem is due mainly to declining family size; this trend toward reduced responsibility for children may well increase private saving for retirement. Private retirement plans are also growing. These developments might bring a social decision to reduce relatively the Social Security component of saving for retirement, thereby cutting back the tax increases.

Once the Social Security scare stories have been laid to rest, the method of financing can and should be overhauled. The earned income credit, already installed in the last income tax legislation, is a modest first step using general revenues to alleviate the worst feature of the payroll tax—its burden on low-income groups. Although it is part of the income tax structure, the original rationale for the credit was to offset part of the Social Security tax.

The credit, in effect, rebates more than 85 percent of the combined employer-employee tax on earners making \$4,000 or less and gives progressively smaller rebates up to the \$8,000 level. This legislation is a major breakthrough, in part because of its tacit recognition that labor bears the entire tax. However, its demands on general revenues are modest—\$1.5 billion—since it is phased out for high-income groups and excludes the childless who predominate among low-income earners.

Payroll tax exemptions are resisted by many social security experts on the ground that some workers would then get something for nothing—thereby undermining the desired "contributory" feature of the system. For example, it has been said that rich and poor should pay the same for social security, just as they are presumed to pay the same for a loaf of bread. However, the facts do not support this analogy. The food stamp program already discounts the price of bread for nearly 20 million Americans. Similarly, low-income persons have always received more social security benefits per dollar of tax paid than high-income persons. In other words, income redistribution is already going on in both of these areas.

The relationship between benefits and taxes is already a loose one, and it is appropriate to loosen it somewhat further in order to alleviate the unfair burden on low-income families.

By offsetting only 10 percent of the 11.7 percent social security tax, the earned income credit retains a net 1.7-percent contribution by low-income earners. This should reassure those who believe that everyone should contribute something to earn a right to benefits. If extended to childless earners, it would be a major reform of the most untenable aspect of the social security tax. The revenue cost of such an extension would be around \$5 billion a year, or about 6 percent of the social security tax yield. This could be done in conjunction with a further improvement relating the size of the credit to family size. Then, the payroll tax would have, in effect, a fair system of exemptions similar to those under the income tax.

Further substitution of general revenue financing would still be in order. Current proposals for the medical and nonmedical portions of the tax complement each other perfectly. A logical suggestion by the Advisory Council is to move gradually toward financing the hospital portion of social security benefits out of general revenues. There is a precedent for this, since a part of the medicare program is already financed by general revenues. Moreover, the lack of relationship between medical benefits and earnings history undermines the traditional case for financing benefits via the regressive payroll tax. If fully accomplished, this change would mean—on a current basis—substituting revenues from more equitable taxes for 15 percent of the payroll tax.

A more far-reaching move in the same direction is the proposal by Representative James A. Burke and about 135 cosponsors at the last count. It would cut the nonmedical portion of the payroll tax from 4.95 percent to 3 percent for both employers and employees. The indicated overall revenue loss of nearly 40 percent would be recouped by increasing the taxable ceiling and using general revenues for one-third of nonmedical social security financing. The desirability of a large ceiling increase is debatable. There is a question as to whether social security taxes and benefits should be extended that high into the income range. However, a "Government contribution" was mentioned as a longrun goal by the framers of social security legislation in the thirties. It is time to take this step.

In conclusion, ending the excessive and unintended double adjustment of benefits for inflation would check the widely feared escalation of costs and tax rates, and clear the way for payroll tax reform. Refinement and extension of the earned income credit would eliminate at a modest cost the most unfair feature of the payroll tax. The Advisory Council and Burke proposals would cut back the medical and non-medical components of the tax.

Together, these three moves would constitute substantial substitution of progressive for regressive financing of social security. Eventually, this process can be pushed further without jeopardizing the basic quality of social security as a contributory system. In the meantime, these three reforms would be major steps forward, long overdue. It is time to rein in the runaway benefit escalator and get on with these reforms.

Mr. BURKE. Thank you very much, Mr. Brittain.

Without objection, we will include the more detailed statement by John A. Brittain at this point in the record.

[The statement follows:]

STATEMENT OF JOHN A. BRITTAIN*

FINANCING SOCIAL SECURITY

Over the last two years the press has launched new assaults on the Social Security system, alarmist forecasts of mounting taxes and even predictions of insolvency. One sensational five-part series widely distributed last year by the New York Times News Service headlined: "The Social Security System Is Bankrupt." According to that analysis, written by Warren Shore, the system "can only survive through larger and larger acts of public charity or a total reorganization." In reality, however, there is no such crisis.

The Social Security system is suffering growing pains. Indeed, the new automatic benefit escalator must be slowed down before it carries benefits to unrealistic levels, and the soaring, unfair Social Security tax must be reformed. But these problems are soluble. The benefit escalator in the 1972 legislation contains a major defect, but it is easily reparable. After benefits are brought under control, steps can be taken to make the Social Security tax more equitable. The bankruptcy charge is a fantasy, and a senseless generator of fear among participants and beneficiaries.

As a critic of one feature of the system—the payroll tax—I have been incorrectly cited in support of some of these irresponsible and sweeping criticisms and associated proposals for change. This is a welcome opportunity to set the record straight, consider various criticisms of the benefit and tax structure and discuss proposals for payroll tax reform.

WILL SOCIAL SECURITY TAX RATES BECOME INTOLERABLE?

Recent critics have argued effectively that the payroll tax is unfair and that the entire Social Security system is shot through with inequities. Some have gone beyond that, however, to forecast wrenching crises threatening the very existence of the institution. It may be well to consider first these apocalyptic prognoses that are now so prevalent. Some common elements of the thesis are that the promised retirement benefits cannot be counted on by the taxpayer, that the taxes necessary to finance future benefits may prove to be so enormous as to be intolerable, and that the system may then default on its obligations in the face of rising taxpayer resistance.

This gloomy prophecy is based on recently legislated escalators providing for automatic adjustment of payroll taxes and Social Security benefits. The first raises the individual taxable maximum (and thus the average tax base) as average earnings rise; the second escalates benefits on the basis of movements in the consumer price index (CPI). The tax rate necessary to finance the escalating benefit depends, of course, on the relative size of the future earning and beneficiary populations, as well as the rate of change of earnings and prices. It is easy to show that the combination of a relatively small working population, a slow growth of earnings and a rapid inflation would put financial pressures on the system, and require high tax rates in order for it to meet its obligations.

What has alarmed some critics is the very high tax rates that would be called for under unfavorable population, earnings and inflation forecasts. For example, one estimate published this month by the Board of Trustees of the Social Security Trust Funds assumes declining fertility, increasing longevity, earnings growth of 7 percent per year and a price index rise of 5 percent. Under the present escalator formulas, this would require an increase in the payroll tax from about 10 percent now to 12 percent in the year 2000, and a 26 percent rate by 2050—even when hospital benefits are excluded. Due to a defect in the escalator, the required rates would be even higher if earnings grew at an 8 percent rate and the price index grew by 6 percent, even though the real earnings growth would be almost the same. The required rate for the hospital insurance tax would also rise substantially.

*John A. Brittain is a Senior Fellow at the Brookings Institution and author of *The Payroll Tax for Social Security* (Brookings Institution, 1972). The views in this statement do not necessarily represent those of the officers, trustees or other staff members of the Brookings Institution.

The 26 percent figure may seem horrifying at first glance, but any long-range forecast is both highly speculative and extremely sensitive to the dynamic assumptions. The assumptions above imply a real earnings growth rate of about 2 percent. Under a 3 percent growth assumption, there would be no significant change in the required tax rate. Of course, the estimates would be even more hair-raising if a real growth rate of only 1 percent were assumed.

Though it seems unlikely, what if a real earnings growth rate of only 1 percent or less did indeed materialize? Would there be taxpayer riots? Would the elderly be abandoned? The answer, of course, is that the escalator formulas are not frozen in concrete until 2050 and beyond; they can easily be revised. In fact, it is already apparent that, through a technical oversight, the complex mechanism linking benefits to the CPI would escalate benefits far more rapidly than intended by the legislation. For example, an earlier official projection based on the 1 percent growth rate, shows a median earner retiring at age 65 in the year 2045 with a basic pension equal to 89 percent of taxable earnings in his last year. Many others would retire with basic pensions higher than any wage they ever earned! Even the 89 percent ratio is more than double the current typical ratio, and it is unlikely that the 32 percent tax rate needed to finance it would be tolerated. Obviously the first legislative move needed to silence the recent prophets of doom is an amendment overhauling the benefit escalator to provide for more realistic—but still adequate—benefit levels during the next century.

Although the benefits of retired workers move up reasonably, in lockstep with the CPI, the key problem is that the present formula overescalates the future benefits of workers who have not yet retired. In effect, these workers receive a double adjustment for inflation: The conversion ratios relating pensions to past earnings are "indexed" by the CPI, but the resulting increases are added on top of the market adjustments to current money wages that tend to accompany CPI increases. The result is that inflation can increase without limit the ratio of the retired worker's basic pension to his final year's earnings; in fact, a ratio of 200 percent could easily arise. Actually, there are offsetting influences in the computational procedures which restrain this benefit acceleration somewhat. Even so, it is becoming recognized officially that the growth of benefits would be excessive under the current regulations.

While no rate of benefit growth will satisfy everyone, it should be easy to reach a compromise that at least eliminates the double adjustment now taking place. Future benefits should indeed grow as the economy grows and be protected against inflation. The Advisory Council has just presented a logical and practical proposal to achieve this by simple change in the present law. It would adjust past earnings (rather than conversion ratios) to allow for earnings growth before computing initial retirement pensions. (Then pensions would, as now, be indexed by the CPI.) This alternative to the present irrational scheme would allow for productivity gains and protect against inflation. Congress need only amend the 1972 legislation in this way to assure that real benefits maintain a desired and feasible relationship with the real earnings base from which they must be paid. Although the problem of overescalation of benefits is not immediately serious, it would be well to correct the procedure soon to deflate recent assertions that the Social Security system is rapidly going bankrupt.

The stabilization of real benefits relative to the individual's adjusted wage history would eliminate the most frightening aspect of current Social Security projections. Even after the benefit escalator has been reined in, the problem of demographic pressures will still remain. A substantial rise in the ratio of the retired population to the working population is indeed forecast. However, studies have shown that this would require an increase of no more than a few percentage points in the tax rate. A careful and detailed demonstration of this is available in a forthcoming Brookings study.¹

In the event of demographic trends and productivity gains even more unfavorable than those currently projected, the Social Security system would still not collapse. Real benefits would simply be scaled down to allow for that situation. Even if such revisions prove necessary, benefits would probably still improve, although at a slower rate than under the current formulas. Congress would adjust the tax-benefit structure as it has been doing for years, and the program would continue to yield rising real benefits for most people.

It should be added that most of the dire forecasts have failed to mention developments that seem likely to make matters easier for the system. In the first place,

¹ Barry H. Blechman, Edward M. Gramlich, and Robert W. Hartman, *Setting National Priorities: The 1976 Budget*, The Brookings Institution (forthcoming). See, especially, Table 5-2 and the related discussion.

the increasing prominence and reliability of private pension schemes (now federally guaranteed under legislation enacted this past September) may make a slower-than-scheduled growth rate for Social Security benefits more acceptable. Second, it should be remembered that a major reason for the expected rise in the ratio of retirees to workers is a projected decline in family size. This decline is another reason to expect future retired generations (who will have spent less on their children) to be less dependent on Social Security. At the same time, even if higher taxes were nonetheless called for, the attendant decline in the number of children per family would make the taxes easier to bear. (This entire discussion assumes, of course, that our economywide Social Security program will never encounter severe difficulty such as that faced in the railroad industry, which is covered by an independent social security-type system. There the earning population shrank so much in relation to the number of beneficiaries that federal contributions to beneficiaries became necessary.)

WHAT DO THE CRITICS WANT?

The mere possibility of periodic adjustments of the benefit structure by Congress is, of course, anathema to some critics of Social Security. They would like to convert this program into something equivalent to the private purchase of an individual annuity. The absence of fixed commitments to beneficiaries under Social Security has led some critics to propose a drastic revision of the retirement program. One proposal (sometimes associated with Milton Friedman, James Buchanan and Colin Campbell) would make participation in Social Security voluntary, replace the payroll tax by bonds sold to those who participate, and require nonparticipants to buy the same bonds on the open market.

One can believe that the payroll tax is a regressive and unfair device borne entirely by labor, and still oppose its replacement by the bond scheme. It is true that this approach might well guarantee that every individual would get back everything collected in his name plus interest. However, the bond plan would continue to tax low income individuals by forcing them to buy bonds, even though they are recognized as incapable of paying income tax. It would also end the present favorable treatment of low income families. (The latter now tend to earn a relatively high lifetime return on their contributions since the benefit structure is more regressive.) Moreover, the failure to adjust benefits for inflation would also injure middle income earners, as well as those less well off.

Even without adoption of the bond plan, placing Social Security on a voluntary basis would itself undermine the lifetime progressive effect of the present tax-benefit structure; upper income participants would have relatively high incentives to drop out. There are, of course, many inequities in the present structure, including the treatment of working married women, who gain very little in benefits in exchange for their payment of taxes. However, these can best be dealt with on an ad hoc basis along with other reforms of the tax. The Social Security system is the target of much valid criticism, but it also may have done as much to alleviate poverty as any American institution. Its ills, including those of the payroll tax, can be treated without razing the entire structure and starting over.

SHOULD A LARGE TRUST FUND BE ACCUMULATED?

A proposal for accumulation of a large trust fund is elaborated by Martin Feldstein in his written statement to this Committee. The proposal is in keeping with (though not dependent upon) his finding that the Social Security program is depressing private saving. His estimates of this effect on saving have recently been scaled down to a plausible level, but his astonishing proposal for accumulation of a giant trust fund calls for critical examination by everyone concerned with Social Security.

Feldstein proposes an increase in the retirement portion of the Social Security tax from about 10 percent now to 20-25 percent per year. The objective is accumulation of a \$600 billion trust fund and ultimate abolition of the Social Security tax (within a decade). Under certain assumptions, Feldstein forecasts a huge net welfare gain from this policy. This raises at least two questions that require future consideration.

The proposal is set forward at a time that taxes are being cut to stimulate an economy in recession. Feldstein proposes a Social Security tax increase on the order of \$100 billion per year. In effect, this would amount to forced saving aimed at the ultimate release of private funds for investment and the acceleration of growth. The funds would be used to buy up federal, state and local bonds, as well

as private mortgage debt—thus tending to bring down interest rates) in the absence of offsetting Federal Reserve policy). The hope is that the decline in interest rates would promote rapid growth and stimulate private investment sufficiently to offset the severe drag imposed by the tax increase. However, there is no way of estimating reliably the responsiveness of investment to a change of this magnitude. It could easily fall far short of the needed effect, thus aggravating this severe recession, or bringing on a new one.

A second major disturbing feature of the Feldstein proposal is its aggregative nature. In effect he is asserting that the social rate of return is well in excess of the social discount rate (or time preference rate), so that increasing saving will make almost everyone better off. But the 6 percent discount rate in his illustration is typical of rates established in the market where the supply side is dominated by the small minority who do most of the saving. The great majority for whom Social Security is really intended accomplish little or no saving; for many a discount rate as high as 50 percent may be typical, and some would have to pay an even higher rate than that to borrow.

For example, consider the family of five earning \$5,000 and exempt from the income tax by the ability-to-pay criterion. The Feldstein proposal would raise the nonmedical portion of his family's Social Security tax from \$500 to about \$1,000 to \$1,250 per year. Who is prepared to say that the fruits of expanded productivity would ever compensate such a family for this large tax increase? Moreover, who is to guarantee that the primary beneficiary of the tax increase will be the housing industry and other activities of direct benefit to low-income families?

The immediate effects of the Feldstein policy would be a severe fiscal drag and a further regressive redistribution through the expanded payroll tax. Unless a much stronger case for equitable benefits from ultimate productivity gains can be made, the proposal cannot gain wide support.

WHAT IS WRONG WITH THE SOCIAL SECURITY TAX?

It should be emphasized that one can reject the voluntary approach to Social Security and the substitution of bond sales for the Social Security tax without implying any enthusiasm for the burden of the present payroll tax. The maximum tax per employee has soared from \$60 in 1949 to \$1,650 in 1975. If, as argued below, employees actually bear the entire payroll tax, a two-earner family will pay about \$3,300 in payroll taxes in 1975. Although there is nothing necessarily wrong with the rapid growth of a tax, its relentless acceleration in this case inevitably raises questions about its purpose, burden and equity. It is important to note that, although there is a declared war against poverty, this fastest growing of all our taxes is one levied on employment income, without exemptions for families in poverty. This absence of exemptions, combined with the ceiling on taxable earnings, results in effective payroll tax rates for the working poor that are far higher than those for upper income groups. Making matters worse, taxes have generally exceeded benefits in the past. For example, between 1965 and 1971, revenues exceeded benefits by \$13 billion. These surpluses enabled the government to make federal expenditures that would otherwise have required increases in other forms of taxation.

Why have these features of the payroll tax failed to draw much attention until recent years? The idea that the Social Security tax is a contribution to a trust fund analogous to a payment toward a private annuity undoubtedly contributes to tolerance of the tax. However, this analogy is misleading in many ways, primarily because the relationship between individual lifetime contributions and benefits is a very loose one, and is subject to continual legislative change. Given these facts, there is something wrong with encouraging the impression that the Social Security tax is an insurance premium. As taxpayers become more aware of the flexibility in the tax-benefit relationship, their view of their contribution as basically their own individual savings seems bound to change. Such a re-evaluation would slow the growth of this tax.

There is also something wrong with a tax that may owe its acceptance in part to the fact that its true bite is not directly felt or perceived by the taxpayer. For example, in weighing its impact on individual earners, there is a tendency to consider only the employee half of the tax. If, as economic theory suggests, the employee pays the employer's share as well as his own, the burden on earners is twice as great as that seen by most observers. It may be useful to defend this proposition briefly.

On a common sense, empirical level, it is helpful to think of two countries which are identical except that one has an employer tax rate of about 40 percent (as in Italy) and the other only a 5 percent tax. The first country can be expected

to have a far lower basic wage than the second. My statistical studies have shown this to be the case. In fact, my findings indicate that, given the level of productivity, the higher the employer payroll tax rate in a country, the lower the basic real wage—and the rate is lower by about the same amount. This relationship indicates that the tax is coming out of labor's share, though that does not imply that workers get nothing in return. Obviously, they receive associated benefits from the government, or workers with an effective 40 percent tax rate would not tolerate it. The point is that labor is paying for its benefits, even though the tax is nominally paid by the employer.

How is the employer tax shifted to employees? Employers may respond to payroll tax increases by granting lower wage increases than warranted by productivity gains. They may also reduce real wages by marking up product prices. The long run net result of these two types of adjustment is that increases in the Social Security tax on employees will reduce by about the same amount the real basic wages they offer for labor of a given quality. Since the tax is nearly universal, there is no reason to expect a resulting contraction of the supply of labor. Assuming that the supply of labor responds very little to these tax increases, the real burden clearly falls on labor's share. If there is some reaction in the supply of labor, the process and outcome are more complicated, but there is no reason to believe that a substantial part for share of the tax would come out of the share of capital.

The chief indictment against the payroll tax is that it places a heavy burden on the low-income worker; the ability-to-pay criterion that exempts him from the income tax does not apply. If we include the unemployment insurance payroll tax, the highest total tax rate on wages and salaries is now about 14 percent, and that rate is paid by those earning less than the unemployment insurance taxable ceiling—generally \$4,200. Because of this ceiling, the payroll tax rate on one earner begins to decline after \$4,200; this decline accelerates, of course, after an individual's earnings exceed the Social Security ceiling of \$14,100 (up from \$13,200 in 1974). Thus, an individual earning \$150,000 will pay a tax rate of only about 1 percent. Although the income tax contains many special preferences, its rate structure is generally progressive, in sharp contrast to the regressive structure of the payroll tax.

The ability-to-pay criterion has always been accepted as fundamental to the design and evaluation of the income tax. When the Nixon administration took office in 1969, one of its early acts was to provide low-income relief from the income tax. This was to alleviate the situation in which families then officially classified as living in poverty were paying this tax. Scarcely a voice was raised, however, concerning the payroll tax paid by these same families, even though it was a much greater burden for them than the income tax. Under the insurance principle, the working poor continued to be taxed at the highest rate of all. If the ability-to-pay guideline is valid for our largest and fairest tax, why should it not also be applied to the Social Security tax?

CAN SOMETHING BE DONE ABOUT THE SOCIAL SECURITY TAX?

Once the Social Security scare stories have been laid to rest, the *method* of financing can and should be overhauled. Despite the many undesirable features of the payroll tax, it appears certain to keep growing, though probably at a slower pace than indicated by the more pessimistic forecasts. Not only are the existing taxes expanding, but new payroll taxes are contained in national health proposals now under consideration. The worst features of the payroll tax could be alleviated by at least partial substitution of general revenue financing; this is certainly a worthy long-run objective. However, although the new Supplemental Security Income program is financed from general revenues, no large-scale substitution of general revenue financing for payroll taxes appears in the cards. If we are to live with ever-increasing payroll taxes, we should at least consider attempts to reform them.

It is encouraging that the burdens and inequities of the payroll tax are finally receiving official recognition. Casper Weinberger, Secretary of Health, Education and Welfare, has spoken strongly of the unjustifiably high burden of Social Security taxes on low income earners and raised the possibility of exempting some portion of these incomes from the tax. Although there appears to have been no follow-up to this statement, the consideration of payroll tax reform has at last been brought to the highest level of governmental decision-making.

Several proposals have been drawn up by congressmen in recent years. A modest plan calling for exemption of earnings below the total of exemptions and allowances

due each family under the income tax (and phased out at earnings levels double those totals) has been drawn up as a resolution by Senator Gaylord Nelson. Although this was a relatively inexpensive plan covering the employee half of the tax only, its introduction has been stymied, pending decision on recommendations for offsetting revenue gains by means of tax reforms.

A more far-reaching plan has been proposed by Senators Muskie and Mondale. It applied to the employee and self-employed portions of the tax and entailed the same exemptions and allowances as under the income tax. Although these were not phased out for higher incomes, it was estimated that the revenue loss could be entirely offset by removal of the taxable maximum from the tax on employees, employers, and the self-employed. Although payroll tax revenues would remain virtually unaltered, it is clear that this change would have made the Social Security tax far less regressive than at present.

HOW EFFECTIVE ARE CURRENT MOVES TOWARD GREATER EQUITY?

The "earned income credit," already installed in the last income tax legislation, is a modest first step using general revenues to alleviate the worst feature of the payroll tax—its burden on low-income groups. Although it is part of the income tax structure, the original rationale for the credit was to offset part of the Social Security tax. The description explicitly cited as its rationale the fact that families in poverty are exempt from almost all income tax implied that the payroll tax should treat them about the same way. The credit, in effect, rebates more than 85 percent of the combined employer-employee tax on earners making \$4,000 or less and gives progressively smaller rebates up to the \$8,000 level. This legislation is a major breakthrough, in part because of its tacit recognition that labor bears the entire tax. This helps undermine the pretense that the employer portion of the tax is borne by the employers themselves and is therefore of no great concern to workers. The demands on general revenues resulting from this credit are modest—\$1.5 billion—since it is phased out for high-income groups and excludes the childless who predominate among low-income earners.

By offsetting only 10 percent of the 11.7 percent Social Security tax, the law leaves a net 1.7 percent tax on low-income earners. This should reassure those who believe that everyone should contribute something to earn a right to benefits. If extended to childless earners, it would be a major reform of the most untenable aspect of the Social Security tax. Presumably, exclusion of the childless was primarily intended to make credit for amendment more salable in the tight budgetary situation. In the presence of the Aid to Dependent Children Program, there is no reason to believe that low income, childless individuals and couples are any more capable of paying payroll taxes than those with children. Certainly some single individuals such as college students have low incomes because they work part time, not because they are really poor. Perhaps they could be excluded by basing eligibility on hourly earnings; this seems preferable to excluding all childless persons. In any case, this problem is no different from that under the income tax. The revenue cost of extending the credit to childless earners would be around five billion dollars a year, or 6 percent of the Social Security tax yield. This could be done in conjunction with a further improvement relating the size of the credit to family size. It is surprising that a fixed \$4,000 income was set as the credit base, without linking exemptions to family size and responsibilities. If this were done, the payroll tax would have, in effect, a fair system of exemptions similar to those under the income tax.

Even in its present form the earned income credit partially relieves millions of families of an unfair tax. Its effective downgrading of the misleading "insurance principle" is also a good thing: it has an educational effect and also indicates some common sense understanding of the true incidence of the payroll tax. This legislation could well lead eventually to more substantial alleviation of the burdens imposed by the Social Security tax. Passage of the credit marks a step forward on this front that is considerably more significant than indicated by its modest price tag.

Payroll tax exemptions are resisted by many social security experts on the ground that some workers would then get something for nothing—thereby undermining the desired "contributory" feature of the system. For example, it has been said that rich and poor should pay the same for their social security, just as they are presumed to pay the same for a loaf of bread. However, this analogy is unrealistic. The food stamp program already discounts the price of bread for nearly 20 million Americans. Similarly, low-income persons have always received more Social Security benefits per dollar of tax paid than high-income persons. The relationship between benefits and taxes is already a loose one, and it is appropriate

to loosen it somewhat further in order to alleviate the unfair burden on low-income families.

Further substitution of general revenue financing would still be in order. Current proposals for the medical and non-medical portions of the tax complement each other perfectly. A logical suggestion by the Advisory Council is to move gradually toward financing the hospital portion of Social Security benefits out of general revenues. There is a precedent for this, since a part of the Medicare program is already financed by general revenues. Moreover, the lack of relationship between medical benefits and earnings history undermines the traditional case for financing benefits via the regressive payroll tax. If fully accomplished, this change would mean (on a current basis) substituting revenues from more equitable taxes for 15 percent of the payroll tax.

A more far-reaching move in the same direction is the proposal by Rep. James A. Burke and about 135 co-sponsors. It would cut the non-medical portion of the payroll tax from 4.95 percent to 3 percent for both employers and employees. The indicated overall revenue loss of nearly 40 percent would be recouped by increasing the taxable ceiling and using general revenues for one-third of non-medical Social Security financing. The desirability of a large ceiling increase is debatable, but a "government contribution" was mentioned as a long-run goal by the framers of Social Security legislation in the thirties. It is time to take this step.

CONCLUSION

Ending the excessive and unintended double adjustment of benefits for inflation would check the widely-feared escalation of costs and tax rates and clear the way for payroll tax reform. The Advisory Council and Burke proposals would cut back the medical and non-medical components of the rising payroll tax. Together, these three moves would constitute substantial substitution of progressive for regressive financing of Social Security. Eventually, this process can be pushed further without jeopardizing the basic quality of Social Security as a contributory system. In the meantime, these three reforms would be major steps forward—long overdue. It is time to bring the benefit escalator under control and get on with these reforms.

Mr. BURKE. Our next witness is Mr. Feldstein, economist from Harvard University. Welcome, Mr. Feldstein.

Mr. FELDSTEIN. Thank you, Mr. Chairman.

Mr. BURKE. You are recognized, Mr. Feldstein.

STATEMENT OF MARTIN FELDSTEIN

Mr. FELDSTEIN. Thank you.

I am pleased to be here this afternoon to discuss this important subject with you. I have given you a formal statement, "Strengthening Social Security," but I won't read from it this afternoon.

Mr. BURKE. Without objection, your entire statement will appear in the record, and you may summarize as you wish.

[The prepared statement follows:]

STATEMENT OF MARTIN FELDSTEIN, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

STRENGTHENING SOCIAL SECURITY

Social security was the most important government innovation of the Great Depression. Forty years later, nearly every aspect of our economic life has changed dramatically. Yet the basic structure of our social security program has not been reexamined and reshaped to the economic conditions of today. Instead, the original program has simply continued to expand at an ever increasing rate.

In the fiscal year ending in June 1975, social security benefits for the retired, the disabled and their dependents will exceed \$67 billion. This represents a more than three-fold increase from the \$20 billion in 1965. Even after adjusting for inflation, benefits have increased by 102 percent in the last decade. This expansion of benefits has occurred at an even faster rate during the most recent five years.

Real benefits rose 56 percent during these years while real GNP rose only 10 percent.¹

At the same time, the social security tax has also increased very rapidly. In 1965, employees and employers paid a combined tax of 7.25 percent on the first \$4800 of income; the maximum tax was thus \$348. In 1975, the tax is 11.7 percent on the first \$14,100 for a maximum of \$1650. The maximum tax per covered worker is now nearly five times as great as only 10 years ago.²

There are many who think of social security as a quite passive program that provides income to older Americans who would otherwise live in poverty on inadequate savings or be dependent on welfare or children for their support. In this view, social security is simply a transfer program with little or no real effect on anything but the distribution between young workers and older retirees. This common belief is simply not true.

Because of the vast size of the social security program and its central role in the American system of financing retirement, it has major effects on all of the significant dimensions of our economy. These effects are currently unintended, generally unperceived and frequently undesirable. The most important impact is a substantial reduction in the nation's rate of saving. This reduction in savings makes our capital stock much lower than it otherwise would be. With less capital, our national income is reduced and wage rates are lower. Moreover, the specific form of the reduction in saving greatly increases the unequal concentration of the ownership of wealth.

The primary reason for this problem is that the social security program has not kept up with the changing economic conditions. When the current social security program was designed, the nation was at the bottom of the great depression. The length of the depression and the failure of financial institutions had wiped out the lifetime savings of a great many families. More than 20 percent of the labor force was unemployed. The new Keynesian economics stressed that the depression would persist as long as the full-employment rate of savings remained greater than the rate of investment. The fear that an excessive savings rate would cause a permanent depression remained a firm conviction of many leading economists into the 1940's. In contrast, the past 25 years have seen a relatively low average unemployment rate of 4.8 percent. The early fear of excessive saving has now changed to a serious concern about a capital shortage in the years ahead. Not surprisingly, the appropriate social security system for today is very different from the system that was appropriate 40 years ago.

The major economic issues involved in social security reform are quite distinct from the problem of financial bankruptcy that has been widely discussed in the popular press during the past year. A story in *U.S. News and World Report* in July 1974 declared that the social security system is in desperate financial condition and concluded that "The failure to reform social security, almost everyone agrees, could lead in the long run to disaster." A month later, the *Wall Street Journal* quoted this conclusion approvingly and added "It is worse than that." These views were then widely echoed in other newspapers and magazines. There is a strong fear among the public at large that social security may be headed toward financial collapse. This fear of bankruptcy is without merit. It is worth while therefore to discuss this problem of financial solvency before turning to the more important economic effects.

FOREBODINGS OF BANKRUPTCY

The pay-as-you-go method of financing social security is a crucial aspect of the current program and of its financial problem. The government now collects a payroll tax equal to 11.7 percent of the first \$14,100 of each worker's income.³ These payroll tax receipts are used to finance cash benefits currently being paid to retired workers, along with the Medicare benefits of the aged and the cash benefits to disabled workers and surviving dependents. Only a relatively small trust fund of \$55 billion, less one year's benefits, is kept to smooth the flow of receipts and expenditures.

¹ These benefits exclude Medicare benefits for the aged. Medicare benefits have grown even more rapidly than the cash benefits. In 1974 hospital and medical benefits under Medicare exceeded \$12 billion, nearly double the 1969 level. There were no Medicare benefits a decade ago.

² The 11.7 percent tax rate consists of a 9.9 percent rate for old age, survivors' and disability insurance and a 1.8 percent rate for Medicare. The 9.9 percent rate entails a maximum tax of \$1396 and implies a four-fold increase in the maximum tax payment in a decade.

³ Although the employer legally pays half of this and the employee the other half, this is essentially just an accounting convention. The actual distribution of the burden of the tax between wages and profits depends on the effects of the tax on the relative supplies of labor and capital.

In comparison to this trust fund, the social security system now has liabilities of more than \$2.4 trillion.⁴ This means that current members of the system, working and retired, are expected to receive \$2.4 trillion more than they are expected to pay in future taxes. If social security were a private pension program, it would require current assets of \$2.4 trillion to be financially solvent, i.e., to guarantee its ability to its future obligations. Since the social security program has a trust fund of only \$55 billion or some 2 percent of its obligations, social security is bankrupt by the conventional standards of the actuarial soundness of private pension programs. This analogy of social security to private pensions is, however, totally misleading. A private pension program must have sufficient assets to meet all prior commitments because it cannot be certain that any future contributions will be made. In contrast, the social security program can continue to compel future generations of workers to pay social security taxes. These future tax rates can be set so that tax revenues are sufficient to meet the claims of the beneficiaries. The government's power to tax is its power to meet the obligations of social security to future beneficiaries. As long as the voters support the social security system, it will be able to pay the benefits that it promises.

Social security does, however, face a financial problem in the future. If nothing were done to change the current social security law, it is likely that the social security tax rate would have to rise very rapidly in the years ahead. This is due in part to an unintended feature of the 1972 social security legislation that all experts agree is an error that should be corrected. This problem of "double-indexing" for inflation is described in the next paragraph. The more significant long-run financing problem caused by the changing demographic structure of the population will then be discussed.

Before 1972, the social security program had no explicit method of adjusting benefits for changes in the cost of living. Instead, Congress frequently gave ad hoc increases in benefits that generally more than compensated for the effects of inflation. In 1972, Congress enacted a basic change in the law. Starting in June 1975, all benefits will increase automatically in accordance with changes in the cost of living. This is a desirable reform that protects the real value of retirees' benefits from the haphazard effects of inflation. Unfortunately, the specific method of indexing benefits adopted in the 1972 legislation contains a very serious technical flaw. As the law now stands, inflation will affect current and future workers in two ways. When prices and wages rise, the "average monthly earnings" on which social security benefits are based will also rise. In addition, the current method of indexing also raises the benefits at each level of average monthly earnings. Thus, inflation raises benefits in two cumulative ways.

This "double-indexing" makes both the value of benefits and the required tax rate hypersensitive to the rate of inflation. A useful way to measure benefit levels is the "replacement ratio", i.e., the ratio of benefits at age 65 to the earnings immediately before retirement. The actuaries of the Social Security Administration have estimated the effects of different rates of inflation on the replacement rate for a "typical" married retiree who had previously had the median level of earnings. During the 25 year period from 1948 through 1973, real wages grew at approximately 2 percent while prices increased about 2.4 percent. With this rate of growth of real wages and a 2 percent rate of inflation for the 75 year forecast period, the "typical" retiree would receive benefits that replaced 63 percent of what he was earning just before retirement.⁵ If prices rose at 4 percent instead of 2 percent, the replacement rate would be increased from 63 percent to 95 percent.⁶ With an even higher rate of inflation, an individual's social security benefits could substantially exceed what he had earned before retirement. This haphazard behavior of the replacement ratio is clearly undesirable. The hypersensitivity of the benefits to inflation also makes the tax rate very sensitive to the rate of inflation. Even with no other adverse influences, a 5 percent rate of inflation would cause the social security tax for retirees and survivors to increase from 10 percent today to approximately 15 percent after fifty years. All experts now agree that the method of indexing should be revised to eliminate the instability of replacement rates and to avoid the possible explosion of the social security tax rate.⁷

⁴ This is an official estimate of the Social Security Administration for the fiscal year ending in June 1974.

⁵ This substantially understates the extent to which benefits replace net wages after income and payroll taxes.

⁶ This assumes the same 2 percent rate of growth of real wages. Because this rate of growth is determined primarily by technological factors, it is much more predictable than the rate of inflation.

⁷ This was recommended recently by the official U.S. Advisory Council on Social Security and by the Panel on Social Security Financing to Senate Finance Committee.

Even with a proper method of adjusting for inflation, the social security tax rate will have to rise substantially over time to maintain the current ratio of benefits to previous income. The primary reason for these increased taxes will be to offset the growing importance of retirees relative to the population of working age. The birth rate has dropped dramatically since 1960 at every age level. A useful summary measure is the total fertility rate, i.e., the average number of babies born per woman in her lifetime. This fertility rate remained above 3 from 1947 to 1964 and then declined sharply and continuously to 1.9 in 1973.⁸ A total fertility rate of 2.1 is required just to maintain the population at its current size in the long run. Even if the fertility rate were to rise immediately to the zero population growth value of 2.1, the demographic structure of the population would change dramatically over the next sixty years. There are now 30 beneficiaries for every 100 workers. The social security actuaries now estimate that, with a fertility rate of 2.1, there will be 45 beneficiaries for every 100 workers in the year 2030.

With the current method of pay-as-you-go financing, this 50 percent increase in the relative number of beneficiaries requires a 50 percent increase in the social security tax rate if benefit replacement ratios are to be maintained. Since the cost of the benefits to retirees and survivors is currently 10.9 percent of the earnings taxed by social security,⁹ the 50 percent increase would bring the tax rate in 2030 to 16.4 percent. The actual future tax rate will also reflect changes in productivity and labor force participation. With less favorable demographic conditions or productivity growth, the tax rate could reach 20 percent or more.¹⁰

An increase in the social security tax rate to 16 percent or 20 percent would be a substantial increase.¹¹ But is this necessarily a serious problem for the social security system. There are some who believe that such high rates would create an intolerable burden on low and middle income families. This is a false argument that ignores the substantial increase in real earnings that these families will enjoy at the same time that tax rates rise. Even a tax rate increase of 10 percentage points over the next 50 years is only an increase of 0.2 percent per year. The higher tax would absorb only one-tenth of the annual wage growth of 2 percent. Stated somewhat differently, a 2 percent annual rate of growth of real wages would raise real wages by 200 percent between now and 2030. The higher social security tax would absorb no more than 10 percentage points of this 200 percentage point increase in real wages.

There is however a very real problem entailed in this projected increase in the social security tax rate. By substantially raising the overall marginal tax rate (including income and sales taxes) of middle and low income households, the higher social security tax rate exacerbates the distortion and disincentives already produced by our current tax system. A specific example will illustrate this point. A family of four in Massachusetts with earnings of \$12,000 currently pays a combined marginal tax of 36 percent including the federal and state income tax and the social security payroll tax; i.e., an extra 1 dollar of gross wages paid by an employer only adds 64 cents to the disposable income of such a family.¹² Increases in the social security tax rate by 10 percentage points raises the marginal tax rate by nearly one-third to 46 percent and reduces the employee's net take-home pay to only about half his gross earnings. Such high tax rates would undoubtedly have substantial effects on the behavior of the labor force.

These calculations of tax rates treat the social security tax as if it were the same as the personal income tax. There is in fact a very important difference. Paying a higher social security tax eventually results in higher retirement benefits. The relationship between tax payments and benefits is loose and haphazard but it is present nonetheless. In contrast, an individual who pays higher personal income taxes does not as a result obtain any more in government services. Because employees perceive that there is a relation between their social security tax payments and their own future benefits, their response to an increase in social security taxes should be quite different from their response to an increase in the personal income tax rates. Indeed, if social security were effectively a compulsory savings program in which each individual received, in return for his tax payments, the same level of

⁸ Preliminary estimates for 1974 indicate that this downward trend has continued.

⁹ The current combined tax rate of employer and employees is 9.9 percent but fails to cover total costs.

¹⁰ This is very close to the 16.2 percent rate estimated by the official Advisory Council on Social Security for 2030. The Social Security Panel of the Senate Finance Committee used less optimistic assumptions about the birth rate and concluded that, with a two percent growth of real wages, the tax rate in 2030 would have to be 20 percent to cover the concurrent costs.

¹¹ There is currently an additional 1.8 percent for disability and health. There is every indication that these costs will continue to rise very rapidly.

¹² The 3 percent Massachusetts sales tax on most items other than food and clothing further reduces the value of this disposable income.

benefits that he would have obtained by investing his tax payments, there would be no effect of the social security tax on work incentives. As the required tax rate grows, it becomes more important to move toward a system in which individual benefits more closely reflect individual contributions, thus reducing or eliminating the undesirable work incentive effects. I will return to this issue in a subsequent section. First, however, I must consider the effect of social security on capital accumulation.

LIMITING CAPITAL ACCUMULATION

The most serious effect of our social security program is to reduce the nation's rate of savings and therefore our rate of capital accumulation. Recall that with our current pay-as-you-go method, social security tax receipts are paid out as concurrent benefits and are not accumulated. There is no real investment of the social security contribution and therefore no interest as such is earned on these compulsory contributions. When we, the current generation of workers, retire, we will not receive social security benefits by drawing down an accumulated fund. Instead, our benefits will be financed by the tax payments of those who are at work when we retire.

Because of the growing population and rising level of wages, the taxes collected in the future will allow us as retirees to receive social security benefits that are greater in total value than the amount we will have paid in taxes while we were working. Past experience suggests that the level of benefits will be equivalent to receiving a reasonable real rate of interest on the previous compulsory contributions to social security. If there is no further expansion of coverage or of benefit replacement rates,¹³ future social security benefits will on average reflect a real rate of return that is equal to the rate of growth of total wage income, i.e., the rate of growth of labor force plus the rate of growth of the wage rate. With zero population growth, the implicit real rate of return would be about 2 percent; although this seems low, it should be remembered that this is a real after tax rate of return and therefore about the same as most low and middle income households have traditionally received from banks or savings bonds.

For most Americans, the social security program is the major form of saving. Consider, for example, an individual who, in the absence of social security, would wish to save 10 percent of his total income for his old age and whose income is \$10,000. With social security, such an individual would need do no saving for his old age. He need only save to accumulate funds with which to buy consumer durables and to have a cash balance for emergencies. Similarly, an individual with an income of \$20,000 who, in the absence of social security, would want to save 10 percent of his income or \$2,000, now finds that social security involves compulsory savings of about \$1,600. He therefore need only save an additional \$400 instead of \$2,000.¹⁴ In 1974, total social security taxes were \$89 billion or 9 percent of total disposable personal income. If individuals think of these taxes as equivalent to savings and reduce their own personal savings accordingly, the effect on total savings would be very substantial. More specifically, in 1974 personal savings were \$77 billion or 8 percent of disposable personal income. An \$89 billion reduction in personal savings induced by social security would thus cut personal savings to less than half of what they would otherwise be.¹⁵

Of course not all private savings are personal savings. Corporate retained earnings account for nearly half of all private capital accumulation. In 1974, these corporate savings were \$53 billion and total private savings were \$130 billion. If social security reduced savings by \$89 billion, the total potential private savings of \$219 billion were reduced by about 41 percent. In the long run, this implies that the U.S. capital would also be about 41 percent less than it would otherwise be.

Because social security taxes are not actually compulsory savings but only an exchange of taxes for an implicit promise of future benefits, it is useful to look at the likely effect of social security on savings in a quite different way. Instead of considering the social security contributions, the individual might focus on his

¹³ Past increases in social security benefits were possible in part because new groups were being added to the covered population. Relatively few workers are now not covered and the \$14,100 maximum causes the tax base to include approximately 75 percent of all covered earnings.

¹⁴ This may be direct saving or through a private pension. Many private pensions are adjusted for changes in social security and provide very different rates of contribution on incomes above and below social security maximum. This "integration" of social security and private pensions is explicitly recognized in the tax treatment of pensions.

¹⁵ The personal savings rate in 1974 was relatively high for the postwar period. From 1948 through 1974, the average rate of personal savings was 6.6 percent.

expected benefits. Being covered by social security is like owning an annuity, i.e., a claim on future annual payments when the individual reaches age 65. Although the individual is not guaranteed these benefits by contract and could in principle be deprived of them by a legislative change, the past experience of the program and the current legislation suggest not only that benefits will continue to be paid, but also that they will increase with the general level of income.¹⁶ These implicit social security annuities are an important part of each family's wealth. An individual with such an annuity could reduce his own private accumulation of wealth—either directly or through private pensions—by an equal amount.

It is therefore interesting to use the total value of these social security annuities as an estimate of the likely effect of social security on the total private stock of real wealth. The total value of these annuities reflects the number of workers at each age, their age specific mortality rates and the mortality rates of their wives, the rate at which per capita income can be expected to grow in the future and the appropriate rate of interest at which to discount future benefits in evaluating the future annuity benefits. In a recent study,¹⁷ I estimated the 1971 value of this social security wealth at \$2 trillion. Since the total private wealth of households in that year was about \$3 trillion, the calculation suggests that social security may have reduced the stock of private wealth about 40 percent, i.e., from \$5 trillion of wealth that would exist without social security wealth to the \$3 trillion that currently exists. The 40 percent reduction is remarkably close to the estimate obtained by looking at the reduction in personal saving that would occur if households viewed social security taxes as an alternative to savings.¹⁸

The relative importance of social security wealth has grown very rapidly in the past two decades. In 1950, social security wealth was 88 percent of gross national product. A decade later it had increased to 133 percent of gross national product. Today it is more than 200 percent of gross national product. The impact on capital accumulation is therefore more important than ever before.

Two caveats must be noted at this point. First, while it is clear that rational men who are fortunate to have had a basic course in economics might understand the wealth implied by the social security program, the typical American household might not behave as this theory predicts. The two preceding calculations showed the extent to which the social security program would reduce private capital if households did substitute social security wealth for private wealth, but they did not show that such substitution actually occurs. Second, even if households are perfectly rational in reducing private wealth accumulation by the value of social security wealth, the effect of social security is more complex than the preceding discussion indicated. As I noted earlier an important effect of the social security program (and especially of the rule that benefits are paid only to those who are effectively retired) is to induce a higher rate of retirement among older persons. A higher rate of retirement will in itself increase the desired rate of savings. A man who plans to continue working until his death need only accumulate enough wealth to support himself if he becomes unable to work before he dies and to support any surviving dependents. If that same man is induced to plan to retire at 65, he will want to accumulate sufficient wealth to provide for his full retirement years. At age 65 a man now has a life expectancy of more than 13 years. Since social security benefits are substantially less than earnings, the induced retirement is likely to lead to some additional private savings.

The net effect of the social security program will therefore depend on the balance between the extra savings due to induced retirement and the reduced savings due to the replacement of private accumulation by social security wealth. The relative strength of these two effects will of course depend on the increase in retirees due to the social security program relative to the number of persons who would be retired in the absence of the social security program. In 1929, 45 percent of men over the age of 65 were retired. By 1971, the retirement rate had increased to 75 percent. Although the higher rate of retirement also reflects higher income, changing life expectancies, and a different occupational mix, the social security system is probably responsible for some of the increase in retirement. Nevertheless, it is clear that even if half of the increase in retirement were attributable to social

¹⁶ Even before the 1972 social security law, benefits were repeatedly raised by ad hoc legislation so that the ratio of the average basic benefit (i.e., the benefit received by a worker with no dependents) to per capita income fluctuated around 41 percent since the beginning of the social security program with no noticeable trend.

¹⁷ "Social Security, Individual Retirement and Aggregate Capital Accumulation," *Journal of Political Economy*, 1974.

¹⁸ As I noted above, the U.S. Treasury recently published an estimate of \$2.4 trillion for the unfunded liability of the social security program. Although the financial liability as such is not important, the \$2.4 trillion is significant as an estimate of the potential effect of social security on the current stock of real wealth.

security, the reduction in savings due to the replacement of private wealth by social security wealth is almost certain to be much greater than the effect on savings of induced retirement.

I recently completed an econometric study of savings behavior in the United States since 1929 that was designed to estimate the net impact of social security on the nation's accumulation of capital.¹⁹ The results confirmed that social security does substantially reduce private savings. More specifically, the statistical estimates imply that social security reduced personal savings in 1971 by between \$40 billion and \$60 billion. The actual level of personal savings in 1971 was \$61 billion. The estimated fall in savings therefore implies that social security reduced personal savings by between 40 and 50 percent. Total private savings, including corporate savings, were therefore reduced by between 32 and 42 percent. I noted earlier that if private wealth were reduced by the full amount of the social security wealth, the decrease in our capital stock would be about 40 percent. The current estimates of a reduction of between 32 and 42 percent in the savings rate therefore imply that the effect on savings of induced retirement is relatively small and that households do rationally respond to social security wealth by reducing their private savings by a corresponding amount.

Some further evidence of a very different type also supports this conclusion. The major developed countries of the world differ quite substantially in the fraction of national income that is saved. The United States, with postwar private savings equal to about 9 percent of national income, is well below average. Social security programs also differ substantially among these major developed countries. The specific parameter values of an econometric model estimated with international data indicate that a higher level of social security benefits and a more complete coverage of the population by the social security program decrease a nation's rate of private savings.

How does this substantial reduction in savings affect the American economy? How would our economy be different if the rate of saving were substantially higher? To be specific in my answers, let me use the estimate that social security reduces the nation's wealth by about 35 percent. If this asset substitution had not occurred, the long run capital stock would therefore be some 55 percent higher than it currently is. As a rough approximation, this implies that gross national product would rise by about 14 percent. For 1974, this implies that GNP would be increased by more than \$197 billion. To put this number in some perspective, note that \$197 billion is nearly 25 percent of total consumer spending, nearly twice the total individual income tax payments and substantially more than twice the level of national defense expenditures. Viewed somewhat differently, \$197 billion is \$920 per person or more than \$2500 per family. Let me emphasize that this lower level of GNP reflects the pay-as-you-go nature of our social security system. It is because social security taxes are used to pay concurrent benefits that the capital stock is smaller and income is less than it would otherwise be.

The substantial reduction in our nation's wealth implies that there is less capital per worker in the economy. This change in the relative scarcity of labor and capital implies that the current social security program decreases wage rates and increases the rate of profit. If in the absence of the current social security system the capital stock were 55 percent greater, the wage rate would rise by 14 percent and the rate of return on investment would fall by 27 percent. This would imply a rather significant redistribution of income to lower and middle income families for whom wage income is much more important than capital income.

The current social security program also has a dramatic effect on the distribution of the ownership of capital. In our country, capital is distributed much more unequally than income. The top 1 percent of income recipients earn some 5 percent of total household income. In contrast, the top 1 percent of wealth holders own approximately 40 percent of the capital owned by all households. How does this greater inequality of wealth reflect the social security system? To the great majority of Americans, the anticipated social security benefits are an adequate substitute for almost all private wealth holdings. Only for those with incomes above the base of the social security tax, now \$14,000 is there a need for substantial private wealth. Stated somewhat differently, if the social security wealth of more than \$2 trillion were instead part of our private wealth, it would be distributed much more equally than the distribution of income. The distribution

¹⁹ "Social Security, Individual Retirement and Aggregate Capital Accumulation," *Journal of Political Economy*, 1974.

of the larger total wealth of \$5 trillion would be much more equal than the current wealth. I have made some estimates that imply that the concentration in the top 1 percent would be halved (from 40 percent today to only 20 percent). The political implications of a very widespread ownership of an additional \$2 trillion of private capital can only be conjectured.

A SOCIAL SECURITY FUND

It is clear that our current pay-as-you-go social security program has several serious bad side effects: a substantially lower level of national income, a redistribution of income to the owners of capital from wage and salary earnings, and a substantial increase in the inequality of wealth holdings. What can be done to correct these harmful effects without losing the advantages of the current social security system? I pose the question this way to emphasize that I disagree with some radical reformers who would abolish our social security system on the grounds that it interferes with each individual's freedom to decide how much to save for his old age. Abolition of social security is inconsistent with our nation's commitment to prevent poverty during old age. Although social security might be replaced by a system of means tested grants to older persons who have neither the income nor the wealth to be self-sufficient, I believe that this would be a self-defeating policy. If the level of benefits were set high enough to provide what would generally be regarded as an adequate standard of living, the new program would be a substantial incentive to workers not to provide for their old age. The means tested benefits would thus have the double disadvantage of discouraging savings and lowering the real income of the aged.

How then should the current social security program be reformed to reduce the harmful effects on capital accumulation? And can this be done without the public hostility and political opposition that might be aroused by a major restructuring of the benefits? Fortunately, it is possible to alleviate the problem without making any changes in the structure of the program that would be noticed by the general public. The problem of reduced capital accumulation arises because the government does no real capital accumulation to offset the fall in savings by households, i.e., because all current tax collections are merely paid out as they are received. If a substantial portion of social security taxes were instead saved and invested by the government, as they would be in a private pension program, the social security system would accumulate reserves that would offset the reduction in private capital accumulation. Stated somewhat differently, the social security program, by collecting more in taxes each year than it paid in benefits, would add to the national rate of saving and would thus partially offset the reduction that it causes in the private savings rate.

Let me emphasize that I am not arguing that a large social security fund is *necessary* to protect the actuarial soundness of the social security program. I explained earlier that the social security program does not need a reserve fund in order to pay future benefits. The power to tax the earnings of future workers makes traditional actuarial soundness irrelevant.

But the fact that a social security fund is unnecessary does not make it unwise. The virtue of a fund is that it would increase the level of income, raise wage rates and lower the cost of capital. The return that society would earn on such a fund in the form of higher future consumption would be well worth the current sacrifice. More specifically, economic studies indicate that society would earn a real rate of return of 15 percent on additional capital accumulation.²⁰ A \$100 investment now would yield the nation an additional \$15 of real goods and services in every future year. This higher income could be used to reduce the future growth of taxes, leaving more for personal consumption and investment.

I have learned from experience that the suggestion of a large social security trust fund raises several incorrect objections. I will discuss the five arguments that I have heard most frequently:

† One: It is frequently alleged that accumulating a social security fund would not add to real capital accumulation. Nancy Teeters, now a senior Congressional budget analyst, provides a very clear statement of this view:

† "A private pension plan can transfer resources over time for the individual by currently investing in productive capital that produces real income in the future,

²⁰ A 15 percent real rate of return may seem unlikely because it is so much higher than most individuals are able to earn. It must be remembered however that the individual's return is reduced by the corporation tax and the personal income tax and may be limited by regulations on bank interest rates. The real return to society includes the taxes received by the government as well as the net income received by the investor. The ratio of before-tax corporate earnings to share prices provides a rough measure of the potential social return on additional investment; for major industrial companies, this now exceeds 15 percent.

whereas the social security surpluses are invested in government securities. The interest on those government securities is a government expenditure that must be financed from current revenues. Creating near-term surpluses to build up large trust funds that will generate large interest payments in the future does not reduce the burden of supporting the dependent population in the year that it occurs. The existence of large trust funds only determines whether the cash-benefit program is going to be financed out of payroll taxes or out of general revenues used to pay the interest on the securities held by the trust fund.²¹

There are two common and crucial errors in this paragraph. Consider what actually happens when the social security program has a surplus with which it buys outstanding government securities on the open market. First, the future interest payments on that debt are paid to the social security program instead of to the private individuals who previously owned the government bonds. Thus, contrary to the implication of Dr. Teeters' statement, there is no need for additional general taxation to make extra interest payments. And the social security program has interest income that permits it to lower the payroll tax and yet still provide the same level of benefits. The burden on the future generation of taxpayers is thus lighter. Second, the private individuals who originally sold their government bonds to the social security fund will invest the proceeds in private bonds and stocks.²² This additional demand for private securities will increase the funds available for private investment. The extra private investment increases the real capital stock and raises future income. In this very real sense, a social security trust fund can transfer resources over time and reduce the tax burden on future generations.²³

Two: There is still a vestige of early Keynesian fears that a social security surplus would produce excess savings and serious recession.²⁴ These concerns have inappropriately been carried from the depression into the present decade. Now our capital market would have no difficulty in adjusting to an increasing rate of savings. With more capital available for investment, the cost of capital would fall. Firms would introduce more capital-intensive techniques of production and would provide more good jobs in capital intensive industries. There is no reason why the United States cannot absorb savings at the same high rates as other developed countries.

Three: Some who would otherwise favor an increase in capital accumulation fear the excessive interference of a social security fund with the private economy. There would be grounds for concern if the accumulation of a social security fund required ownership of physical capital or equity shares in private companies. However, such investments are not necessary. There is currently more than \$500 billion of privately held government debt (including the debt of state and local governments) and more than \$200 billion of additional bonds issued or guaranteed by government agencies. Private mortgages and corporate bonds provide further means for channeling funds to the private capital market without becoming involved in management or equity ownership.

Four: Accumulating a surplus in the near term requires raising the social security tax rate. This is seen by some as unfair or excessively burdensome. It must be remembered, however, that the social security tax is already scheduled to increase substantially in the future in order to deal with the changing demographic structure of the population. By raising the tax rate now, the eventual total increase can be reduced. The interest income of the social security fund will be available to pay part of the cost of the higher benefits. If we do not raise the tax rate now, we will be requiring an unfair burden of the next generation—asking them to pay a much higher tax rate to support us than the rate that we charged ourselves. And, if they do not agree to tax themselves more heavily than we are now taxing ourselves, the benefits that we receive will be very much smaller than we now expect.

Five: Finally, there are some critics who object to lodging such a fund in the social security agency rather than in the Treasury or in some other government department. I recognize that there is no fundamental economic logic for assigning this responsibility to social security. But historically and politically, the social

²¹ Nancy Teeters, "The Payroll Tax and Social Security Finance," in *Broad-Based Taxes: The Options and Sources*, edited by R. A. Musgrave (Johns Hopkins University Press, 1973).

²² This assumes that the government does not undo the achievement of the social security fund by increasing its general deficit.

²³ If some portion of these extra private funds are invested abroad or replace foreign investment in the United States, the social rate of return on them may be lower than otherwise. This occurs when a foreign government collects part of the return in its business income tax or when the U.S. loses corporate tax receipts on displaced foreign investment. The additional investment still transfers resources over time in a productive way and thus alleviates the burden on future generations.

²⁴ In 1941, Seymour Harris, one of the pioneer Keynesians in America, praised the ability of the social security program to reduce total saving.

security system has been viewed as a substitute for private savings and private pensions. The social security agency is therefore the natural place in the government structure in which to locate a public savings or pension fund. Adding to the already existing social security fund should raise none of the ideological or political objections that might be aroused by the creation of a new government investment agency. It is not just coincidence that in other countries the ownership of a large public capital fund has been specifically vested in the social security agency.

A large social security fund would not alter the current unequal distribution of claims to wealth. However, this inequality is in large part an illusion based on incorrectly measuring each household's wealth in a way that excludes the value of social security benefits and private pension rights. The problem is thus largely a false one. The true distribution of wealth would not really be altered if individuals held claims to their retirement income directly instead of through a social security system. But the existence of an actual fund might bring the individual perceptions closer to the economic reality.

IMPROVING FAIRNESS AND EFFICIENCY

Although I have focused on the adverse effects of social security on capital accumulation, there are other serious problems that require careful attention and future action. The most important of these problems is the haphazard and often discriminatory relation that currently exists between individual contributions and subsequent benefits. This is most acute in the treatment of working wives and in the imposition of an earnings test as a condition of receiving full old age benefits.

Working wives pay full social security taxes but receive little or no extra benefits. Under the current law, a man who retires can receive an additional 50 percent of his benefits if he has a dependent wife. The wife may instead receive benefits on the basis of her own previous work but thereby loses her benefits as a dependent. A widow can also choose between collecting 75 percent of her husband's benefit and collecting her own benefit. As a result, for many women it is preferable to claim benefits as a dependent and to forgo the benefits for which they themselves paid taxes. It is thus possible under our current law for a married couple with a single earner to pay less tax and receive more benefits than another couple in which both husband and wife work.

This discrimination against working couples substantially diminishes the perceived fairness of the system. In spite of the progressivity of the basic individual benefit schedule, the treatment of working wives means that many low income families pay more in taxes and often receive less in benefits than higher income families. Finally, the imposition of taxes without corresponding benefits reduces the incentive of wives to work and thus diminishes both their labor force participation and their average hours of work. As the social security tax grows, this unfair treatment becomes a problem of increasing importance.

Although the social security program was intended primarily as a system of income maintenance for the aged, it may now have the effect of reducing the levels of income and consumption for many of those over 65. This is the unfortunate result of the earnings test that is imposed as a condition of receiving full benefits. The rationale for the earnings test has always been unclear and contradictory. In the depression, the earnings test was seen as a way of encouraging retirement in order to open up jobs for younger unemployed workers. At the same time, however, the commonly accepted philosophy of the program was to replace the lost earnings of those who are no longer able to work.

Whatever the rationale, it is clear that many older workers are currently induced to retire by an earnings test that substantially reduces the additional income that can be gained by continued working. A married worker with current net earnings of \$500 per month might be eligible for benefits of \$300 per month; at age 65, the net reward for additional work therefore falls from \$500 per month to only \$200 per month, from about \$3.25 per hour to \$1.25 per hour. Although there are special provisions that permit limited earnings without losing all benefits, it is clear that the earnings test is a substantial work disincentive for many who reach 65.

Those who are induced by the combination of available benefits and the earnings test to retire earlier than they would otherwise have done often receive substantially less in social security benefits than they would have earned if they had continued to work. In the preceding example, retirement causes monthly income to drop from \$500 to \$300. Even with optimal saving during the pre-retirement years, their level of consumption is likely to fall at retirement. The income maintenance goal of the social security programs is thus partly vitiated by imposing an earnings test as a condition for receiving benefits.

The earnings test has a further adverse disincentive effect on younger workers. For a worker who does not plan to retire at age 65, the earnings test means that benefits will be postponed and may never be collected. The earnings test thus reduces or eliminates the value of the benefits that would otherwise follow from paying the social security tax. Without such a return, the tax becomes a disincentive to work and a source of inefficiency in the use of labor.²⁵

The inequities and inefficiencies associated with the earnings test and with the current treatment of working wives should be eliminated. There are a variety of ways in which this can be done. The important thing is to make individual benefits reflect individual contributions as closely as possible.

Eliminating the retirement earnings test would end the current distortion of work behavior and would increase the income of many aged persons who would then prefer to continue working. As an alternative to complete elimination of the test, the value of the monthly social security benefit would be actuarially increased for those who retire after 65 just as it is now actuarially reduced for those who retire before 65. Either of these reforms would end the unfair practice of denying benefits to those who have paid social security taxes simply because they continue to work.

In reforming the tax treatment of working wives, it would probably be best to concentrate on changing the taxation rather than the benefits. The alternative of allowing working wives to collect double benefits as retiree and as wife would provide benefits that are too high in such families and would continue to discriminate against unmarried workers. The alternative of eliminating the benefits for nonworking wives would leave many families with benefits that are too low. Perhaps the simplest approach is to limit each couple's total social security tax base to the current individual maximum (now \$14,000). The taxes on the joint covered earnings up to this amount would be credited to a single account and would form the basis for the couple's future benefits.²⁶ Any tax in excess of the maximum could be rebated by the government as a federal tax credit just as the excess social security taxes are now rebated for an individual who holds more than one job and thus pays more than the maximum social security tax.²⁷

Each of the suggested remedies would require a higher social security tax. Nevertheless, such increases are not important as such if they improve the equity of the system and reduce the current distortions and disincentives. Indeed, as the required tax rate is raised by demographic changes, it becomes increasingly important to reduce or eliminate the disincentive effects that would otherwise be associated with a high tax rate. As I have already emphasized, this requires that those who pay the tax should recognize that their taxes are equivalent to compulsory saving that will be returned with implicit interest in the future. Eliminating the discrimination and distortion entailed in the earnings test and in the current treatment of working wives are well worth the higher tax rate that would follow.

There has been continuing pressure in recent years to reduce the use of the payroll tax and rely more heavily on general revenue to finance social security benefits. Because this would weaken the relation between tax payments and subsequent benefits, it would increase the disincentive that inhibits the supply of labor and would exacerbate the inefficient use of labor. It is therefore better to finance social security by an actuarially fair payroll tax and then to use the personal income with rebatable credits to modify the distribution of income.²⁸

²⁵ Indeed, even for those who know that they will be induced to retire at age 65, the earnings test may be a work disincentive in earlier years. An individual who would, in the absence of the earnings test, prefer to work at 65 does not value the combination of benefits and forced retirement as much as he would value the benefits alone. The earnings test thus lowers the value of the benefits to the individual. The tax payments are therefore not fully compensated by future benefits.

²⁶ This method would create special problems in cases of divorce, remarriage and employment before marriage. Some of these problems already exist. A discussion of the possible remedies for this problem are clearly beyond the scope of the current paper.

²⁷ The current credit is only for the employee's share of the tax. Since this distinction is arbitrary, the full tax should be rebated.

²⁸ In theory, of course, the distinction between the two taxes is completely arbitrary. There should be no theoretical difference in disincentive effect if the payroll tax were abolished and some part of the personal income tax used to finance the same earnings related benefits. Regardless of the tax structure, the disincentive should depend on the "net marginal tax rate", i.e. the incremental tax net of the associated incremental benefits. Although this may be conceptually clear to the economist or the actuary, the typical taxpayer is not likely to see his personal income tax payments in this way. If the benefits are not clearly related to the tax, the taxpayer is likely to ignore the benefits. The best hope for reducing the disincentive effect of the social security finance is therefore to have a separate and actuarially fair payroll tax.

TIME FOR REFORM

Social security has become a central institution in American life. It has vast public and political support. American families generally favor the idea of compulsory retirement savings through such a public program. It is clear that social security will continue in the future to have a major effect on the American economy.

The growth of social security has brought with it unintended and often unsuspected problems. As we approach the fiftieth anniversary of the system, it is time to reform and to update the program to the economic conditions of today and of the years ahead. The recent public concern with the financial problems of social security and the perceived need to revise its financing in anticipation of the changing demographic structure provide an opportunity to address social security's more fundamental economic problems.

Mr. FELDSTEIN. Let me say at the outset that I think we are here today because social security is a great program that has done wonderful things for the American people in the last 40 years, preventing suffering and humiliation and providing a sense of security. I emphasize that because I don't want anything that I say in talking about the problems of social security to be construed as a criticism of the basic aims or the structure of the social security program. But there are important problems which require the attention of the subcommittee.

I want to talk this afternoon about the economic impact of the social security program. There has been a great deal of attention recently, and previous witnesses bear this out, to the problems of financing social security. But its impact on the American economy has been largely ignored.

The most important unintended, generally unperceived and undesirable impact is a substantial reduction in the Nation's rate of saving. This reduction in savings makes our capital stock much lower than it otherwise would be. With less capital, our national income is reduced and wage rates are lower. Moreover, the specific form of this reduction in saving greatly increases the unequal concentration of the ownership of wealth in the United States.

Let me look more concretely at just how this comes about. For most American families, social security is the most important source of retirement savings. Consider a family with \$10,000 of income. Without social security the family might save 10 percent of its income, or \$1,000 a year. Social security makes it completely unnecessary for that family to do any saving except for emergencies. Even a family with \$20,000, which in the absence of social security would want to save \$2,000, now finds that social security causes compulsory savings of about \$1,600. The family need only save \$400 now instead of \$2,000 to achieve the same goal. It reduces personal pension savings accordingly by \$1,600.

What does this imply for total national savings? In 1974 social security contributions were \$89 billion, 9 percent of total disposable personal income. For individuals, this is \$89 billion of compulsory savings. Personal savings, in 1974, were only \$77 billion. If individuals substitute social security for personal savings, that is, if they otherwise would have saved that \$89 billion, their personal savings have been cut in half by the social security program.

Of course, corporations also contribute to our national savings. In 1974 they contributed \$53 billion. So the total private savings in that year were \$130 billion. If the social security contributions had been

private savings instead, we would have had total savings of about \$220 billion. In other words, that \$89 billion potential reduction in private savings is a 41 percent cut in the overall rate of savings.

In the long run, this implies that our Nation's capital stock would be 41 percent less than it otherwise would be.

As you know, the social security program works on a pay-as-you-go basis; there is no public savings to offset this decrease of 41 percent in the rate of private savings.

There is another and possibly better way to look at this problem of the impact of social security on savings behavior. Forget about contributions that individuals pay and focus on the benefits instead. From the point of view of the family, social security is like having a private annuity, a very good one. It promises to pay benefits when they retire at age 65. The social security annuity is the most important part of household wealth in the United States. For most families it is more important than any other source of wealth.

In 1971 social security wealth was about \$2 trillion. Total private wealth of households was about \$3 trillion. Taking those together, household assets were about \$5 trillion, but only \$3 trillion of that was real wealth. If households had substituted \$2 trillion of social security wealth for what might have been real wealth, again we see a reduction in total potential wealth of the economy of some 40 percent.

I should note that the value of social security wealth has been growing rapidly, much more rapidly than national income. In 1950 social security wealth was 88 percent of GNP; a decade later, 133 percent. Now it is more than 200 percent of GNP. So the impact of social security on the capital stock has become more and more important.

Of course, I have been talking until now about how households would behave if they did substitute social security wealth for regular personal savings. This tends to exaggerate the effect. Even without social security some households do no saving at all, and other households save in a less rational way, so they don't offset their savings when social security goes up.

Economic logic only tells us that social security is going to depress total private savings. It can't tell us the magnitude of this effect. That is basically an empirical question. And I would like to report to you some empirical studies that try to assess it.

A study of U.S. savings behavior showed that in 1971 social security did cut personal savings somewhere between \$40 billion and \$60 billion. That means that private savings in that year were reduced by between 30 and 40 percent.

There is further evidence of a very different sort.

Major development countries differ greatly in savings funds. U.S. savings, about nine percent of private income, is at the low end of the spectrum. Social security also differs substantially among major developed countries. If you relate the savings behavior to the social security system and to other factors that affect savings you again find an important causal effect of higher benefits on individual savings behavior.

Let me look now with you at how this reduction of savings affects the American economy. To be specific I will look at the long-run effects associated with the 35 percent reduction in the savings rate about the middle of the range that I mentioned for the U.S. estimates.

That means that our current 9 percent savings rate would alternatively be 14 percent. Without the reduction, the long-run capital stock would be some 50 percent higher. And that means that our national income would be 14 percent higher than it is. At 1974 levels that means \$200 billion more national income, about \$2,500 per family.

The reduction in savings, of course, will also mean less capital for each worker. That means that there are less good jobs and lower pay, less productivity than there otherwise would be. If the capital stock were 50 percent higher, real wages would be about 15 percent higher than they are now. What John Brittain said before about workers bearing the entire social security tax is only part of the effect. They not only bear the tax, their gross wages are lowered because of the social security program.

Finally, the scarcity of capital about which we hear so much these days would also be reduced if our capital stock were larger.

In short, social security has a major impact on the capital structure, and therefore, on the income and wages of the American economy.

I realize that I have been describing a major problem without suggesting a solution. I believe that your subcommittee should give careful attention to the idea of accumulating a large social security capital fund on top of the current Trust Fund that the social security system has. This need not be a fully funded system as a private one would be. The point is not to provide funds to meet future benefits as such. We don't need a trust fund of that size in order to protect the solvency of the system. The power to tax is the power, as John Brittain said, for the Government to meet its commitments to social security beneficiaries.

But the fact that a large capital fund is unnecessary does not mean that it would be unwise. It would have the great advantage of raising our level of income and our wage rates, and it would also represent a fairer share of the future burdens of social security between ourselves and the next generation.

I find that whenever I discuss this proposal for a social security capital fund there is much misunderstanding about how such a fund would work, and what its impact would be on the economy. I hope that our discussion this afternoon will clarify some of these issues and help you to see how a capital fund of this sort could improve the program and be of enormous benefit to the entire economy.

Mr. BURKE. Thank you.

Our next witness is Conrad Taeuber, Director of the Center for Population Research, Georgetown University.

STATEMENT OF CONRAD TAEUBER

Mr. TAEUBER. When the United States established the social security system in the 1930's there were about 8 million persons who were 65 and over and there were 9.5 persons between the ages of 20 and 64 for every older person. Since then the number of the elderly has more than doubled, but the total population grew much less rapidly, and now there are about five persons in the working ages, 20 to 64, for every one of the 22 million older persons.

There will be little change in this ratio by the year 2000 when there will be about 30 million older persons. In the year 2050, there are

likely to be nearly 50 million persons 65 and over, but only about 3.5 persons between 20 and 64 per older person. The number of older persons has increased much more rapidly than the total population, and every indication is that this will continue to be the case well into the next century.

Experience has shown that projecting the size of the population into the future is subject to a great many uncertainties. The problems of projecting future populations become more difficult as one goes farther into the future.

All the persons who will be 25 years old or over in the year 2000 have already been born. But only those persons who will be 50 years old or over in the year 2025 have already been born. However, except for those persons who will be 75 years old or over, all of the people expected to be alive in the year 2050 are still to be born.

What appears in the light of current and recent circumstances to be a reasonable projection may turn out to be far off the mark when the time comes. But no one today would venture to speculate that in the next 75 years we would again increase our population by nearly three times as we did in the last 75, growing from 76 to 213 million. The projections into the future generally assume a much slower rate of growth; in line with the fact that recently our growth rate has been declining to less than 1 percent per year.

Even though our birth rates are currently slightly below the rate which is needed for long-term stabilization of our population, our numbers are likely to increase for some time to come. Thanks to the postwar baby boom we have an unusually large number of women in childbearing ages, and this will continue to be true for some time into the future. As these people move into higher age brackets they increase the population at the higher ages. If they have just enough children to replace themselves, the total population will be larger than it is now, and this will continue to be true until the wave of post-war babies and their replacements have worked their way through the entire age range.

Replacement fertility results in a stationary population in the long run, but in the short run it does not necessarily mean the end of population growth. Last year when we had the lowest birth rate in our history, about 3.2 million babies were born and just under 2 million persons died, for a natural increase of about 1.2 million. Immigration added about 400,000 more to our total.

The number of persons who will be 65 or over at some future date can be established with some confidence. All of the persons who will be at that age in the year 2000 or 2025 are already here, except for the immigrants who may come before those dates. Even for the far-off year 2050, virtually all of the persons who will then be 75 years or older have already been born. Those persons who will then be between 65 and 74 years old will be the survivors of babies born between 1975 and 1984.

Since a large share of the persons who will then be 65 or over are already here, it seems reasonable to estimate the total which is about 50 million. The precise figure depends on the course of fertility in the next 10 years, the course of mortality over the next 75 years, and the volume of net immigration during that time.

In estimating how many births will occur during the next 10 years, a choice has to be made. It can be assumed that fertility will continue

to fall, as it has been doing in recent years. Alternatively, it can be assumed that fertility is likely to increase slightly to the long-term replacement level and remain there. Of course, there are other possibilities.

When young married women are asked how many children they expect to have, the answer averages about 2.1, which is about the level which would be needed for long-term replacement. Even if one accepts that as a reasonable average figure, it would still be necessary to give some consideration to the question whether these children will come close together or whether their arrival will be spread out over a considerable time.

Death rates seem much less likely to be subject to rapid change, though, of course, some major disaster or improvement cannot be completely ruled out. It is generally assumed that these rates will continue their slow declines as they have done in recent years. Nor can anyone foretell when, if at all, there will be some breakthrough in the control of the diseases which are the most frequent causes of death at the advanced ages.

The statement that people live longer than they used to really means that a larger fraction of the babies born live to become old enough for social security. For example, a white baby boy born in 1900 had only a 39-percent chance of living to observe his 65th birthday. His counterpart born in 1970 is estimated to have a 66-percent chance of reaching that milestone. But the white man who had reached that age in 1973 had only about a 2-year advantage in expectation of further life over his counterpart who reached that birthday in 1900.

Immigration is subject to congressional action, and the volume of immigration could again be altered, as it was by the act of 1965. Immigration, however, is not a major element in the growing number of persons who are 65 and over. Some years ago the Census Bureau prepared a projection of the population of the United States, and used as one assumption that there would be no net immigration after 1974. They found that by the year 2000 the number of persons 65 years old and over would differ by less than 500,000, under 2 percent, if there were no further immigration or if immigration continued at its current levels.

The projection of the number of persons who will be 20 to 64 years old at future dates is subject to the uncertainties that surround the projection of the number of births in the future. Nearly all of the persons who will be 20 to 64 in the year 2000 have already been born. But for the year 2025 the majority of that age group are yet to be born. And for the year 2050 the entire group will be the survivors of babies born after 1985.

This is not to cast doubt on the projections for this age group which are the basis for the estimates in the number of earners who will be making contributions to the system by that time. They appear to be reasonable. But they are subject to much less certainty than the estimates of the number of persons who will then be 65 and over.

Another set of assumptions relates to the number and proportion of that 20- to 64-year-old population which will be in the labor force and subject to making required contributions.

Nearly all men in that age bracket are in the labor force though early retirement may reduce somewhat the percentage of men in the

upper ranges of that age group for whom that is the case. The proportion of women who are working outside the home has been increasing, and no doubt will continue to increase. However, the assumptions that underlie the report of the Board of Trustees appear somewhat high in the light of other projections which have been prepared by students of labor force behavior.

In drawing attention to uncertainties which surround some of the basic assumptions it is intended only to emphasize that even when assumptions appear reasonable at the present time, it is not possible to make firm predictions. A clear recognition of the limitations which are inherent in some of these estimates and projections provides a better basis for action than if these limitations were not known or ignored.

Thank you, Mr. Chairman.

Mr. BURKE. We are glad to welcome back our next witness. He is a familiar face, Robert Myers, professor of actuarial science, Temple University, former chief actuary for the Social Security Administration.

STATEMENT OF ROBERT MYERS

Mr. MYERS. It is a real pleasure to be back again with the Committee on Ways and Means. It is particularly pleasurable to be here in this historic room where over the last 25 years I have spent some very interesting and very busy days.

The question before us essentially is what is the financial problem of the OASDI system. Certainly, the press has vastly overemphasized the difficulties that the program is having now and will face in the future. These difficulties can be solved relatively easily.

The program is not bankrupt in the sense that it is in a hopeless condition, and people will not get their benefits next month or next year. The short range difficulty, as some of the previous speakers have pointed out and as shown by the 1975 trustees report, is that the fund will run out of money some time between 1979 for the disability insurance fund, and perhaps 1980——

Mr. BURKE. Let us recess so that we may go vote. We will be right back.

[A recess was taken.]

Mr. BURKE. The committee will come to order.

You are recognized again, Mr. Myers.

Mr. MYERS. As I was saying, the short range problem is that both the OASI trust fund and DI trust fund will, according to the latest estimates contained in the 1975 trustees report, run out of money at some time between 1979 and 1982 or 1983. In fact, I believe that these estimates are not sufficiently conservative because they assume that, each year from 1976 to 1980 wages will rise at a rate 3 percent faster than prices. I do not think that that will happen, even with there being less unemployment than now. Thus, I think that the short range progress of the fund will be more unfavorable than the trustees have shown.

The long-range problem, as you have heard, is an average of 5.32 percent of taxable payroll.

Now what caused these problems? As to the short-range, the primary difficulty was the economic conditions that we have been

going through at present. The fault has not been with the automatic adjustment provisions that were enacted in 1972, because even if they had, with foresight, been enacted on a decoupling basis, we would still have the short-range problem we have now.

The fault in the automatic adjustment provisions is one that has an effect only over the long-range and has relatively little effect over the short range.

The second problem that resulted in the short-range difficulties was some lack of conservatism in the 1972 amendments when the cost estimating method was changed from using statistic assumptions with a static benefits structure to dynamic assumptions with a dynamic benefit structure. I think that the assumptions then were not made on a sufficiently conservative and prudent basis, and as a result the taxes scheduled for the future were lowered somewhat and therefore there are these short-range problems.

As to the long-range problems, the major difficulty, as some of the previous witnesses have said, is the way the automatic adjustment provisions operate over the long-range—particularly with unfavorable economic conditions such as seem to be predicted for the future. These assume that wages will rise only slightly more rapidly than prices and that both will rise fairly rapidly.

I have seen some criticism that the Congress just did not know what it was doing when it adopted the automatic adjustment provisions. I always rise up in defense of Congress, and perhaps a little bit in defense of myself since I was around when these were developed. The Congress did know what it was doing when it adopted these provisions.

What Congress did in 1972 was merely to put into the law exactly what had been done in every ad hoc benefit adjustment that was made in the 1950's and 1960's and even the early 1970's. That method had worked just fine under the economic conditions then prevailing. The increases were adequately financed by this procedure, and there were no financing problems. If economic conditions were to be in the future as they had been in the 1950's and 1960's these automatic adjustment provisions on a coupled basis would have worked out very successfully.

True, in hindsight one might say, why was it not foreseen that conditions would change in the economy of the 1970's and 1980's and 1990's from what it was in the 1950's and 1960's? Nonetheless, I think Congress had very good reasons for enacting what it did in 1972.

The other long-range factors that have caused financial difficulties are the following—the population trends that Mr. Taeuber has mentioned; retirement rates higher than had previously been anticipated—in other words, people are retiring or being forced to retire much earlier than they had previously so that, if employer practices were changed to permit people to work longer, some of the financial problems would be solved; and the unfavorable disability experience.

As members of the subcommittee well know, your staff assembled a report on the disability experience under the program and showed how it had deteriorated quite a lot over the past few years, and how in turn this has produced some of the financial problems.

What can be done to solve the financial problem of OASDI? The first step, as some of the previous witnesses have said, is to restructure the automatics. I have submitted to you a rather long

statement or actuarial study on this matter, going into the subject in quite some detail, which I hope you will make a part of the record of this meeting.

Mr. BURKE. Without objection, this entire statement will be included in the record at the conclusion of your remarks.

Mr. MYERS. Thank you, Mr. Chairman.

In my study I attempt to give a complete picture of how the present automatic adjustment provisions operate, why they were adopted, and how they would operate in the future under certain economic conditions. I then go on to suggest how the benefit computation procedure can be decoupled.

My suggestion largely patterns the general principles enunciated by the Advisory Council on Social Security, but in my report I go into some very specific details as to how this should be done. The Advisory Council more or less expressed only broad principles. In certain respects I have a slightly different approach than the Advisory Council.

Also, I examined the approach that was recommended by the panel of the Senate Finance Committee that examined this matter. This panel suggested indexing by the past changes in the Consumer Price Index, although it recognized that wage indexing, as the Advisory Council recommended, could also do an effective job.

I have done some work to see whether indexing by the CPI would work out satisfactorily. I came to the conclusion that it would not. The real solution to the problem is to index by wages.

I would also like to point out that this restructuring of the automatics would take care of most of the increased deficit that was shown in going from the 1974 trustees report to the 1975 trustees report. The 1974 report showed an actuarial deficiency of 2.98 percent of payroll on a long-range basis. The 1975 report showed a deficit of 5.32 percent. With decoupling, almost all of this increase would have been taken care of. In other words, decoupling will take care of almost any increase in deficit caused by changes in economic conditions and will produce stability of both the benefits level, and therefore the financing.

The other step that should be taken to solve this financing problem is merely to increase the tax rates. The combined employee-employer rate should be increased by one percent, a half percent on the employee and a one-half percent on the employer. This should be done immediately at the beginning of next year, or certainly by the beginning of 1977 at the latest. Then, another one percent increase will be necessary some time in the early 1980's.

Finally, in around the year 2010, when the baby boom of the late 1940's reaches retirement age, there should be another increase that may be in the neighborhood of another 1 percent on the employer-employee combined.

Now what should not be done to solve this problem? Some people propose that at least part of the solution should be to raise the maximum taxable earnings base more than will result under the automatic adjustment provisions now in the law. This seems to be very attractive in some ways, because it brings in large amounts of money initially. But I think that it is undesirable.

For one reason, such an increase in the earnings base also creates large benefit liabilities in the future, because as the taxable earnings go up, so too do the creditable earnings, and this produces larger benefits.

Also, raising the earnings base will narrow the area in which the private sector can operate to supplement social security to provide economic security.

Still another reason, and one I think that has not been realized by many people is that if the earnings base is increased, this gives windfall benefits or bonanzas to current older highpaid workers. Let me give you an example of this.

If the base for 1975 had been \$24,000, as some people suggest, instead of the actual \$14,100, a man retiring at age 65 next January would have received a primary benefit which would be \$9.30 a month larger than under present law. For that, he would have paid an additional tax of \$579. The actuarial value of this benefit is \$1,137, or just about twice what he paid in taxes. If he were married, with a wife the same age, it would have been even more of a bonanza. The actuarial value of the combined benefits for the couple is \$2,036, almost four times the taxes he would pay. In other words, raising the earnings base would provide these uncalled for windfalls to present older workers with high salaries. Certainly, this is not a proper procedure in a social benefit system such as social security.

Another proposal that has been made is to have a Government subsidy to OASDI. With all due deference to the chairman, I must oppose the idea of introducing a Government subsidy. I am opposed to this for several reasons.

First, there is the difficulty with the Federal budget at the moment being so greatly out of balance. Second, I think this approach has the possibility of destroying, or at least greatly damaging, the earned concept of benefits. Furthermore, I think that the introduction of a Government subsidy tends to hide the cost of the program and to make covered workers and beneficiaries feel that they are getting something for nothing.

Also with due deference to the economists here, I disagree with them that, by moving over to general revenues financing at least in part or even in whole, this will change the incidence of the taxes. I don't agree that the employee pays the entire employer tax himself. Perhaps this is true in the aggregate, but this is not true for each employee individually.

Furthermore, I don't think that it is possible ever to really know what the incidence of taxes is. It is difficult—in fact, I think impossible—to measure what the incidence of taxes is after they have been paid. But to estimate what the incidence of taxes will be in the future if the taxing structure is changed so as to obtain more general revenues in place of payroll taxes is really impossible. Certainly, if higher taxes are levied on corporations, they will pass these on, in one way or another. I don't think you can say in advance how this will be or what its effect will be.

It has been mentioned that the Committee on Economic Security, which framed the Social Security Act of 1935 recommended a Government subsidy to the system eventually. This is true. But it also should be known in this connection that President Franklin D. Roosevelt overrode the recommendations of the Committee on Economic Security and insisted that the system should be self-supporting over the long-range—namely, financed entirely by payroll taxes. This principle has been followed in the almost 40 years of existence of the program.

Finally, Mr. Chairman, I would like to mention one other element of cost which involves equal treatment of men and women under social security. This is something that I have been in favor of for a long time. I have been pleased to see that the system has gradually moved in that way through legislative changes. For example, through the efforts of Congresswoman Martha Griffiths in 1967, there was completely equal treatment begun for men and women insofar as child survivor benefits are concerned.

Recently, as I am sure you are aware, the Supreme Court took the ball and ran with it and decided that benefits should be paid for young fathers if the wife dies and was a covered worker, just as is done in reverse. In other words, the Supreme Court added father's benefits.

The situation now is one of confusion and sort of being in limbo as to aged husbands and aged widowers. There is still a dependency requirement in the law, so there is different treatment of men and women.

I would most respectfully urge the committee to grab the ball from the courts and run with it by enacting legislation that eliminates these differences in treatment by sex. Surely, the courts will at some time in the near future make this change. It seems much better to do this in a rational and orderly manner through legislation.

At the same time, I would hope that the Congress would institute a change—as was recommended by the Advisory Council on Social Security—so that when benefits are offset under the antiduplication provision, this be done for all governmental benefits and not OASDI ones alone. In other words, what I am talking about here is that at present, if both a man and wife have OASDI earnings records, the wife can only get in essence the larger of the two benefits that are coming to her from her husband as a wife or from her own earnings record. That is proper procedure, but it should be extended to apply to all other types of governmental benefits, particularly when husbands are made eligible.

If the courts decide or if Congress does not act first on this, there can be the very anomalous situation of the man who has been working in the Government under civil service retirement for his entire lifetime and his wife who has worked in private industry. When they both retire, he will get a very generous civil service retirement pension. His wife will get an OASDI benefit and the husband's OASDI benefit will be paid to him. If they had instead both been working in OASDI, the overlap would not have occurred. So I think it is very important that this antiduplication provision should be extended to all governmental benefits.

As you will recall, there is a precedent for this. Your committee introduced such a provision with regard to the so-called Prouty benefits that originated on the other side of the Capitol, under which benefits are paid to certain people over age 72 who were not insured, under OASDI but those benefits are offset by any governmental benefit that was payable such as a State teacher's retirement benefit.

I think that, by this action of the Committee on Ways and Means in the conference, the provision was made into a really rational and reasonable one.

Thank you, Mr. Chairman.

[The statement follows:]

THE CASE FOR INDEXING OF SOCIAL SECURITY BENEFITS FOR CHANGES IN WAGE LEVELS

(By Robert J. Myers, F.S.A., M.A.A.A., Professor of Actuarial Science, Temple University)

A number of studies in the past few years have indicated that the automatic-adjustment provisions in the Old-Age, Survivors, and Disability Insurance program (commonly referred to as Social Security) will create significant instability in the sizes of the benefit amounts computed for new retirees and other beneficiaries entering the benefit rolls. At the same time, it has been pointed out that, under prevailing and likely future economic trends of earnings and prices, such instability will cause the cost of OASDI to increase sharply. As a result, the present tax schedule will be insufficient to support the program.

Other factors will also have this effect on the financial status of OASDI, such as: the changed demographic outlook for the future as a result of lower fertility; increased disability retirements; and lower average retirement ages. Studies which have pointed out these cost effects of the automatic-adjustment provisions and other factors are listed in chronological order in items (1) through (8) of the appended Bibliography.

This study will examine only the aspects of the OASDI program that relate to the automatic-adjustment provisions. These provisions and their current basis will first be discussed. Then, various possible alternatives will be presented, along with detailed examples as to how some of these will operate. From this analysis, a recommendation will be made as to the best possible solution to the problem.

SUMMARY

The analysis in this report has been devoted to examination of the problems^s involved with the computation of benefits under the present procedure contained in the OASDI system. Such problems lie only in the determination of the initial benefit amounts for persons newly retiring, and not in the subsequent CPI adjustments while they are on the benefit rolls.

It is concluded that the general type of a decoupled procedure using a wage-indexed earnings record and a benefit formula adjusted for future changes in wages (and closely duplicating the results under present law for near-future retirees) recommended by the Advisory Council on Social Security will best solve the problems of instability of the benefit structure—and thus of financial solvency of the system. This report goes into considerably more detail than did the Advisory Council and makes more specific and definite recommendations, including a particular benefit formula that the author believes is best.

Some study is given to adopting a CPI-indexed (or "real wage") approach. The author believes that the resulting mixture of the two elements, wage changes and price changes, will not produce logical results and cannot be implemented by a specific, definite prescribed procedure that will produce socially adequate and just results.

PRESENT AUTOMATIC-ADJUSTMENT PROVISIONS

The 1972 Amendments to the Social Security Act (P.L. 92-336) included provisions for the automatic adjustment of the following four elements of the OASDI program:

- (1) Benefits newly awarded.
- (2) Benefits in payment status following award.
- (3) The maximum taxable and creditable earnings base.
- (4) The annual and monthly exempt amounts in the earnings test (sometimes referred to as the retirement test).

In brief, both the benefits newly awarded and in payment status are adjusted for changes in the Consumer Price Index (CPI), while the earnings base and the exempt amounts in the earnings test are adjusted for changes in the level of wages in covered employment. Adjustments are made only for increases in these economic elements, not for any decreases which might occur. Further, adjustment of the earnings base and the exempt amounts in the earnings test are made only when the benefits were automatically adjusted in the previous year (for June).

Specifically, both the earnings base and the exempt amounts in the earnings test as applicable to a particular calendar year are based on the figure for the previous year increased by a factor. This factor is the percentage increase in the average covered wage per individual with wages in the first quarter of the previous

year over such average wage for the second previous year. The result is rounded to the nearest \$300 for the earnings base, the nearest \$120 for the annual exempt amount, and the nearest \$10 for the monthly exempt amount.

The adjustments are based on the first-quarter covered wages for several reasons. First, such wages represent, to all intents and purposes, the *total* wages of the individuals involved. This is the case because few individuals are affected by the maximum taxable earnings base in the first quarter (i.e. only those earning in excess of four times the earnings base, which is \$14,100 in 1975). Or, to put it another way, any average of *reported* wages for later quarters would, because of the earnings base, not be representative of *total* wages.

Second, such procedure can be based on a 100-percent tabulation of all such wages. It thus is not subject to the uncertainty or variation that would result if sample or survey data were utilized.

Third, the use of first-quarter data makes it possible to have the results readily available for the October 1 promulgation required by the law. Thus, the covered population will have sufficient advance notice.

It should be observed that the foregoing procedure does not utilize the earnings data for the self-employed or for agricultural workers, since such information is reported on only an annual basis. This exclusion, however, probably has no significant effect on the results, because such data are only a small proportion of the total.

An example of how the earnings base and the annual exempt amounts in the earnings test were actually adjusted can be seen from what was done for 1975.¹

The average covered wage for the first quarter of 1973 was \$1,895.04, while the corresponding figure for 1974 was \$2,007.69. Thus, the increase was 5.94 percent. When applied to the \$13,200 earnings base in 1974, this gave \$13,984, which was then rounded to \$14,100. Similarly, the 5.94 percent increase was applied to the annual and monthly exempt amounts in the earnings test of \$2,400 and \$200, respectively, for 1974. This yielded \$2,543 and \$212, respectively, which were then rounded to \$2,520 and \$210.

Benefits for beneficiaries on the roll in June of each year are increased by the percentage increase in the CPI (rounded to the nearest tenth of a percent) from the first quarter of the preceding year² to the first quarter of the current year. However, such increase must be at least 3.0 percent, or no change in benefits is made (and the base quarter remains the same for the next year's computation).

At the same time, the benefit formula applicable to new retirants and other beneficiaries in the future is uniformly increased. The CPI increase is applied to each benefit factor in the benefit formula.

An example of how the benefit formula was actually adjusted can be seen from what was done when monthly benefits were increased by 8.0 percent for June 1975. The benefit formula immediately before then was:

- 119.89% of the first \$110 of AMW, plus
- 43.61% of the next \$290 of AMW, plus
- 40.75% of the next \$150 of AMW, plus
- 47.90% of the next \$100 of AMW, plus
- 26.64% of the next \$100 of AMW, plus
- 22.20% of the next \$250 of AMW, plus
- 20.00% of the next \$175 of AMW,

where AMW is the computed average monthly wage. The 8.0 percent increase was applied to each of the benefit factors, so that the formula then became:

- 129.48% of the first \$110 of AMW, plus
- 47.10% of the next \$290 of AMW, plus
- 44.01% of the next \$150 of AMW, plus
- 51.73% of the next \$100 of AMW, plus
- 28.77% of the next \$100 of AMW, plus
- 23.98% of the next \$250 of AMW, plus
- 21.60% of the next \$175 of AMW.

When the earnings base is increased, as of the January following the benefit increase, a 20 percent benefit factor is applied to the new band of earnings covered. For example, if the base should rise from the \$14,100 applicable in 1975 to \$15,300 for 1976, another term would be added to the foregoing benefit formula—namely, 20.00 percent of the next \$100 of AMW.

¹ The 11-percent benefit increase made for June 1974 by P.L. 93-233 was deemed by this law to be an automatic adjustment for purposes of automatically adjusting the earnings base and the annual exempt amounts in the earnings test.

² For the June 1975 benefit increase, the base period was specified by the law to be the second quarter of 1974, rather than the first quarter.

DEVELOPMENT AND RATIONALE OF AUTOMATIC-ADJUSTMENT PROVISIONS

It is generally agreed that the automatic-adjustment provisions as they are applicable to the maximum taxable earnings base, the earnings test, and benefits for beneficiaries on the roll (i.e., in payment status) are working satisfactorily. Therefore, the discussion in the remainder of this report will be devoted to such provisions as they relate to benefit computations for future retirees and other beneficiaries.

The present procedure may be said to be of a "coupled" character in that the increase for those on the roll is also applied to the benefit formula applicable to new beneficiaries. This was the identical procedure that the Congress followed for all the ad hoc benefit increases legislated after 1954 and up through 1972. This procedure has the great advantages of simplicity and the creation of a smooth junction (i.e., consistency of benefit amounts) for those on the roll at the time of the increase and those coming on the roll shortly thereafter. It also produces smooth, consistent, and equitable results for recomputation of benefit amounts when persons work beyond the minimum retirement age at substantial earnings levels.

But this procedure can be adversely criticized by stating that it involves a so-called "double dip" or undeserved advantage. This is said to arise from the fact that higher benefits result from both (1) the increased benefit factors and (2) the likely higher earnings credits that the beneficiary has as a result of the higher level of general earnings and the increases in the earnings base due to the operation of the automatic-adjustment provisions.

Such criticism is, however, not entirely valid. There should also be considered two offsetting or counterbalancing factors. One is the weighted benefit formula (such that the benefit amount decreases relatively as the average wage increases). The other is the career-average nature of the average wage (such that it is computed over many years, ultimately 35).

Depending upon the relative trends of prices and earnings, these various factors can exactly offset each other or, more likely, can produce instability in the benefit level over the long run. Correspondingly, under the latter circumstances there will be instability in the financing of the system.

By stability of the benefit structure is meant that the ratio of benefit to final earnings of a steadily-employed person with an earnings history that moves in the same manner as the general earnings level will be the same in all future years as is the case currently. This would be applicable, for example, to categories such as individuals with maximum taxable earnings in all years or individuals with median earnings. Such benefit ratio is sometimes referred to as the "replacement ratio."

As it so happens under the structure of the present benefit formula and the automatic-adjustment provisions, stability of the benefit ratios will occur if economic conditions are such that earnings increase at a rate of 4 percent per year, while prices rise at a rate of 2 percent per year. As it so happens, this was approximately the experience in the period from 1954 to about 1965, so that the ad hoc adjustments made by the Congress then worked out quite satisfactorily by the method later incorporated in the automatic-adjustment provisions.

If earnings rise at twice the rate that prices do, but not at the 4 percent/2 percent conditions, then stability of the benefit ratios will still prevail, but at a different level ultimately than that currently applicable. Thus, if the increase in wages is in excess of 4 percent, the ultimate level of the benefit ratios will be lower than at present—and vice versa.

The situation changes drastically when the rates of increase of earnings and prices are not in a 2-to-1 relationship. Thus, if earnings increase more than twice as rapidly as prices, the benefit ratios decrease over the years, which is not a satisfactory situation because this means declining benefit adequacy.

On the other hand, if earnings rise less rapidly than twice the increase in prices—which is the case currently and seems likely for the future—the benefit ratios increase steadily over the years. In fact, eventually, the benefit ratios will rise to heights that will exceed final takehome pay (or, later, even final gross pay). At the same time, and of course as a result, the cost of the program will mount steadily and will be far more than can be financed by the present tax schedule.

Accordingly, it seems essential that the benefit computation procedures for new beneficiaries under the automatic-adjustment provisions should be revised. This should have the effect of producing a rational benefit structure and, at the same time, a sound financing basis. Although the effect of such action would be to prevent excessive benefit levels in the long-distant (and, even, intermediate)

future, it should not be characterized as a "deliberalization," because under certain conditions (as mentioned previously) it could produce *larger* benefit ratios than under the present procedures.

VARIOUS POSSIBLE SOLUTIONS

Several possible solutions to this problem of the instability of the OASDI benefit structure under conditions other than 4-percent earnings increases and 2-percent price increases have been proposed.

One proposal would merely legislate a maximum on the benefit ratios, possibly varying inversely with the earnings level. It would seem that this approach would have difficulties of application when benefit levels rose near the prescribed maximums and appeared to be heading higher except for this restriction (which would seem "unfair" to some). Also, it would not seem to be effective to prescribe maximum tax rates and to reduce benefits so that they would be able to be financed by such tax rates.

Another proposal would make use of the aforementioned effect of a 2-to-1 relationship between earnings and price increases in stabilizing benefit ratios. The same procedure for adjusting the benefit formula as it applies to new retirees would be followed as now, except that the benefit factors would be increased by the *lesser* of the increase in prices or 50 percent of the increase in wages. This approach would produce greater stability of the benefit ratios (and thus the cost of the system), but by no means complete stability.

Yet another proposal would use a final-average wage in the benefit computations and then have a new benefit formula of a dynamic nature. The final-average wage might be something like the average of the highest five years in the last ten years. The new benefit formula would have constant benefit factors in the weighted formula, but the band limits would be increased in the future as the general earnings level rises. This approach too would result in greater stability, but not necessarily complete stability. Moreover, the use of a final-average wage would not work out satisfactorily or equitably for persons with greatly varying relative earnings over their lifetime work careers.³

The complete goal of stability of benefit ratios can be achieved only by the procedure of indexing the earnings record. This has been proposed by both the 1974 Advisory Council on Social Security and the Panel on Social Security Financing to the Senate Committee on Finance (see items (7) and (6) in the Bibliography).

By "indexing the earnings record" is meant that each year's recorded earnings would be multiplied by the ratio of a certain economic index for the year of computation to that index for the particular year. The indexed earnings record would then be used to compute an average indexed monthly earnings (AIME) in the same manner as is now done for the AMW. The resulting AIME would then be applied in a new dynamic benefit formula (as will be described subsequently).

The economic index to be used in the indexing process could be based either on wages in covered employment (as is now used for the adjustment of the earnings base) or on the CPI. The Advisory Council recommended the former, whereas the Senate Finance Committee's panel preferred the latter, although believing that either index would probably be satisfactory.

The remainder of this report will be devoted to a more intensive analysis of the indexing procedure. Various alternatives as to benefit formulas and indexing methods will be examined.

VARIOUS METHODS OF INDEXING THE EARNINGS RECORD

As just mentioned, the earnings record can be indexed either by an earnings index or by a price index. The former approach thus develops relative earnings, while the latter develops real earnings.

First considering indexing by an earnings index, there are several possible specific indices that could be used. One is the series of figures based on tabulated actual data for all workers with wages in the first quarter of each year, exclusive of agricultural wages and self-employment income (since these are reported on an annual basis, not quarterly). Another is the series of figures based on estimated total earnings (including amounts above the earnings base) for all workers with wages in each year, published in the Annual Statistical Supplement of the Social Security Bulletin.

The relative differences between the resulting indexes for these two sets of data are not great, as can be seen from the following table:

³ A final-average basis can be very successful in the pension plan of a single employer, because the employee's work history with that employer will generally be of the nature of a steady progression of salary.

Year	Average annual wage based on 1st-quarter data		Average annual earnings based on annual data	
	Amount	Index	Amount	Index
1951.....	\$2,813	100.0	\$2,552	100.0
1973.....	7,580	269.5	6,869	268.1

The average wages based on quarterly data are naturally somewhat higher (by about 10%) than the average earnings based on annual data, because the former are more akin to full-time earnings rates. But the important thing is that the index for 1973 is about the same under both approaches. Accordingly, it is much more preferable to use the quarterly data because of the following reasons:

(1) The quarterly data are available more promptly (the 1974 quarterly data was published in October 1974; the latest available published annual data as of April 1975 was for 1973, and that was only a preliminary figure).

(2) The quarterly data are based on 100% tabulations of actual data, whereas the annual data are, to a considerable extent, estimates.

(3) The quarterly data are already being utilized in the automatic-adjustment procedures (for the maximum taxable earnings base and for the annual and monthly exempt amounts in the earnings test).

Another earnings index that might be considered is the series of maximum taxable earnings bases themselves. This would possibly be satisfactory if the earnings base had maintained about the same relative position in the past years (and would do so in the future too, as it will if the automatic-adjustment provisions are left to operate without any ad hoc legislative changes). But the earnings base has increased significantly, from a relative standpoint in 1973-75 as compared with its position in 1951-72. For example, in the 1951-72 period, about 80% of all earnings in covered employment were taxable (by being below the base), whereas in 1974-75, this proportion was 86%.

The inappropriateness of using the earnings base for indexing purposes can be seen by considering what would result for a worker who had average earnings (based on the first-quarter wage data) in each year 1951-75. His indexed earnings applicable to retirement at age 65 in 1976 would be about \$11,000 to \$14,000 per year for the various years in 1951-72, but only \$8,579 for 1974 and an estimated \$8,778 for 1975. Thus, his average indexed annual wage for his highest 19 years (as used in the benefit-computation procedure) would be \$12,214, or 39% higher than his last year's wage, a most unrealistic result.

Next considering indexing by a price index, the only reasonable choice is to use the Consumer Price Index.

Table 1 shows the two series of suggested indexes—on the basis of earnings and on the basis of prices—for the past experience beginning with 1951. These will be used for computation of the Primary Insurance Amount (PIA) for various illustrative examples for Computation Year 1975.

"Computation Year 1975" is applicable to all deaths and disabilities occurring in 1976 and to all persons attaining age 62 in 1976 or who had attained age 62 in a prior year but had not ever been in current payment status before 1976. Computation Years for years after 1975 are applicable only to deaths and disabilities occurring in the next year after the particular year and to persons attaining age 62 in such next year. For example, Computation Year 1980 would be used for all deaths and disabilities occurring before age 62 in 1981 and for all persons attaining age 62 in 1981.

The method of determining the Computation Year for any individual is thus set entirely by demographic conditions, which are well-established. To use other conditions such as date of retirement, date of filing claim, date of award, etc., would often produce capricious, anomalous results and should not be considered.

The so-called "old start" benefit computation method, which uses earnings going back to 1937, will not be illustrated in this report, although the same general principles would apply to it. In recent years, only 7% of all awards of old-age benefits (to retired workers) were determined under this method.

As an illustration of the method of applying the adjustment factors shown in Table 1, if a person had actual recorded earnings of \$4,000 in 1955, his indexed earnings for Computation Year 1975 under the wage indexing approach would be \$10,564 (\$4,000 by 2.641). Any earnings in 1976 or later years for 1975-computation-year cases, when used in benefit computation procedures, would not be indexed (i.e., a factor of 1.000 would be used).

TABLE 1.—DATA TO BE USED FOR INDEXING EARNINGS RECORD FOR COMPUTATION YEAR 1975¹

Year	Average annual wage		Consumer Price Index	
	Amount ²	Factor ³	Amount ⁴	Factor ³
1951.....	\$2,813	3.121	77.8	2.069
1952.....	2,970	2.956	79.5	2.025
1953.....	3,162	2.776	80.1	2.010
1954.....	3,204	2.740	80.5	2.000
1955.....	3,324	2.641	80.2	2.007
1956.....	3,514	2.498	81.4	1.978
1957.....	3,709	2.367	84.3	1.910
1958.....	3,830	2.292	86.6	1.859
1959.....	3,955	2.219	87.3	1.844
1960.....	4,126	2.127	88.7	1.815
1961.....	4,256	2.063	89.6	1.797
1962.....	4,437	1.978	90.6	1.777
1963.....	4,544	1.932	91.7	1.756
1964.....	4,683	1.874	92.9	1.733
1965.....	4,757	1.845	94.5	1.704
1966.....	4,966	1.768	97.2	1.656
1967.....	5,281	1.662	100.0	1.610
1968.....	5,652	1.553	104.2	1.545
1969.....	5,944	1.477	109.8	1.466
1970.....	6,250	1.404	116.3	1.384
1971.....	6,630	1.324	121.3	1.327
1972.....	7,210	1.217	125.3	1.295
1973.....	7,580	1.158	133.1	1.210
1974.....	8,031	1.093	147.7	1.090
1975.....	8,778	1.000	161.0	1.000

¹ Computation year 1975 is applicable to all deaths and disabilities occurring in 1976 and to all persons attaining age 62 in 1976 or who had attained age 62 in a prior year but had not ever been in current payment status before 1976.

² Annualized average earnings for all persons with covered nonagricultural wages in 1st quarter of year. The 1975 figure is estimated by the author (on the basis of a 9.3 percent increase over the previous year).

³ These factors are multiplied by each individual's earnings recorded for the year to yield his indexed earnings for that year.

⁴ All figures on basis of 1967 equals 100. The 1975 figure is estimated by the author (on the basis of a 9 percent increase over the previous year).

COMPUTATION OF AVERAGE INDEXED MONTHLY EARNINGS

The Average Indexed Monthly Earnings (AIME), it is proposed, would be computed from the indexed earnings record for an individual's Computation Year (as defined in the previous section) in exactly the same manner as is done under present law in computing the Average Monthly Wage (AMW).⁴

The AMW is computed, under the "new start" method for the "n" years after 1950 in which credited earnings were the largest (including years before age 22 and after age 61). For these purposes, "n" equals the number of years after 1955 (or year of attainment of age 26, if later) and before age 62, excluding any year in which the individual was in a "period of disability." For men attaining age 62 before 1975, the closing date is later than age 62 (namely, age 63 for those born in 1912, age 64 for those born in 1911, and age 65 for those born in 1910 or before). In no case, can "n" be less than 2; for old-age benefits, when there is not a "disability freeze," "n" cannot be less than 5. Thus, high earnings received after attaining the minimum retirement age can be substituted for prior years of low earnings. If the individual had retired and then returned to employment, this is accomplished by recomputation.

The AIME would be computed for disability and survivor benefit cases in exactly the same manner, from the indexed earnings record, as is now done under present law for these cases. That is, there would be the same opening dates and closing dates in determining the number of years to be used in the averaging and the period of years from which they could be selected. Earnings received in or after the year of attainment of age 62 would be used unadjusted (i.e. not indexed back to the Computation Year, the year when age 61 was attained).

Exactly the same procedure in all respects would be followed for the AIME as is now done for the AMW, using the indexed earnings record (whether indexed by wages, or the CPI, as the case may be).

⁴ The term "Average Monthly Earnings" in present law has a different meaning than AMW, which is used for benefit-computation purposes. The former term is defined in the law as a figure to be used in determining the maximum total benefit for OASDI and Workmen's Compensation benefits combined for a disabled-worker beneficiary.

It should be noted that if the average wage used for indexing purposes decreases in a year, the actual value of it is used for the Computation Year applicable. This is unlike the procedure for automatic-adjustment of the earnings base, where decreases are never considered.

COMPUTATION OF PIAs FOR WAGE-INDEXED EARNINGS RECORD

Now having described how the AIME's should be calculated from an indexed earnings record, there will next be taken up the subject of the revised benefit formula to which the AIMEs are applied in order to obtain the PIAs. The formula to be so developed should give results for the near future which will closely approximate what the present method yields, for various earnings levels. For illustrative purposes, it is assumed that the new procedure would be first effective in 1976.

In order to have social justice and equity, a savings clause should be provided. It should, in any case, be guaranteed that the PIA resulting from the new earnings-indexed method will not be less than that under the present method, but with such present method being "frozen" to the extent that the factors in the benefit formula will not be increased in the future with changes in the CPI. If this is done, the present formula would be applicable, under the savings clause, in a significant number of cases in the next few years, but would then produce only small additional amounts over what the new procedure would do. However, after a few years, the present formula would only rarely be applicable, as the dynamic aspects of the new procedure take hold.

This section will deal only with the wage-indexing procedure. The next section will examine the CPI-indexing procedure and will contrast the relative effectiveness of the two procedures.

The consideration in these two sections will be limited to retirement cases, for persons claiming benefits at age 62 or over. The cases actually presented are for retirement at age 65. However, the same general results would prevail for retirement at ages 62-64 (or at an older age) and for disability retirement, for which benefits are computed as though the insured person were age 62 in the year of disablement. The subject of benefit computation for survivor benefits, especially deferred ones (as for widow's benefits), will be taken up in the last section.

The Advisory Council on Social Security suggested two possible benefit formulas to be used with a wage-indexed earnings record. The Council pointed out that these were only illustrative and that others were possible to do the job effectively.

One formula for the PIA is in the form, 100% of the first \$X of AIME, plus A% of AIME in excess of \$X. As a specific example, the Council suggested that \$X might equal \$123, and A% might be 31%. The dollar figure (\$123) would be adjusted annually for changes in the wage level in covered employment (as is now done for the maximum taxable earnings base, except that decreases would be permitted).

The other formula is somewhat more complex, being of the form, 100% of the first \$X of AIME, plus A% of the next \$Y of AIME, plus B% of AIME in excess of \$(X + Y), where B% is less than A%. As in the case of the previous formula, the two dollar figures, or ranges, would be adjusted annually for changes in the wage level in covered employment.

The two foregoing formulas could also be expressed in terms of a flat dollar amount, plus a percentage (or percentages) of AIME. For example, the two-term formula in the second preceding paragraph could be written specifically as \$85, plus 31% of AIME.⁵ This would give identical results (within 13 cents) for AIMEs of \$123 or more, but somewhat higher amounts for lower AIMEs. This latter form would somewhat parallel the results under present law, for which, effective for June 1975, the minimum PIA is \$101.40.

The Advisory Council proposed the foregoing basis of 100% of the first \$X of AIME because it believed that a high flat minimum was not desirable since it so frequently was applicable for short-service workers under OASDI who had already acquired adequate vested pension protection in noncovered employment (such as Civil Service Retirement). The present flat minimum PIA of \$101.40 would, however, continue to be applicable in the future but would be frozen at this figure and not be subject to CPI increases, so that it would gradually phase out.

⁵ This formula is derived by splitting the first term, 100% of \$123, into two parts, 69% of \$123 (which is \$84.87) and 31% of \$123 (which, when combined with the second term, 31% of AIME in excess of \$123, yields merely 31% of AIME).

The remainder of this analysis and discussion will relate to this approach of the first term being 100% of the first \$X of AIME, rather than a flat dollar amount, although the results and conclusions would be equally applicable to the other approach.

In the author's opinion, and as will be proven in the following analysis, the three-factor formula is preferable to the two-factor one. Also, the specific percentage factor applicable to the second factor should not be as high as 31%, but rather should be 29%. On this basis, the three-factor formula could specifically be: 100% of the first \$131 of AIME, plus 29% of the next \$800 of AIME, plus 10% of the AIME in excess of \$931.

The 10% benefit factor in the third term differs from the 20% factor in the benefit formula of present law for the highest range of AMWs. The \$931 breaking-point for the third term is about the highest AIME possible in the near future for retirees at age 65—actually, in 1976, \$937 for males and \$950 for females. In the long run, retirees will be able to have AIMEs equal to the maximum earnings base—namely, when all the earnings which they will use in the AIME calculation are for 1974 and after.

The fact that near-future retirees will not be able to have AIMEs equal, or even close, to the current maximum earnings base is due to the base having been increased much more rapidly after 1972 than the general wage level. For example, in 1951–72, the earnings base was only about 1.25 times the average annual wage in covered employment (as shown in Table 1), actually being less than this level in all but five years in this 22-year period. On the other hand, in 1974–75, such ratio was 1.61. It will remain at that level in all future years if solely the automatic-adjustment provisions are operative (and not ad hoc legislative changes as well).

To put it another way, consider the operation of a two-step formula as against a three-step one, with the third step being applicable to AIMEs in excess of \$900 (initially, but adjusted in the future as wage levels change). With all other factors being identical, the two formulas will give virtually the same results in the near future (identical results in the vast majority of the cases).

However, in the long run, as will be shown hereafter, the three-step formula will produce somewhat lower—but still quite reasonable—benefits for the very highest paid workers, and yet identically the same benefit amounts for all other workers. At the same time, and correspondingly, the three-step formula will result in somewhat lower costs for the OASDI system and thus will decrease the long-range actuarial deficit to a greater extent than will a two-step formula.

The remainder of this section will make illustrative analyses for these two possible benefit formulas, the two-step one specifically mentioned by the Advisory Council and the three-step one developed by the author. The former will be designated as Formula A and the latter as Formula B.

The first analysis will consider retirees at age 65 at the beginning of 1976. The following analyses will consider retirees at age 62 in 1994 (in 1991, for the first time, the maximum of 35 computation years for the present AMW and the proposed AIME will be necessary) and in 2010 (when, for the first time, the 35 year computation period can be based on earnings under an earnings base as high relatively as the \$13,200 of 1974 and the \$14,100 of 1975—and thus the maximum AIME for such retirees can equal the current maximum earnings base⁶).

In order to develop illustrative figures for PIAs for retirees in the future, assumptions must be made as to future changes in the wage level in covered employment and, for the present benefit formula, in the CPI. The author has hypothesized certain assumptions for these elements (see Table 2). The figures for 1975–80 are rough grading in from the present conditions to the assumed ultimate levels of 5% annual wage increases and 4% annual CPI increases.⁷ It should be emphasized that these economic assumptions, although believed reasonable by the author, are not predictions of what is most likely to occur, but rather they are useful for illustrative comparative purposes.

Table 3 presents comparative data on the PIAs under present law and under the two proposed formulas for wage-indexed earnings records for a man attaining age 65 at the beginning of 1976 and retiring then, with different past earnings records. Figures are also shown for a woman of the same characteristics, but only for the maximum-earnings case.⁸

⁶ Note, however, that such a situation can prevail much earlier—even in 1976 for certain young insured workers—for death and disability cases.

⁷ A 3% ultimate rate of increase is also considered later.

⁸ PIAs are slightly higher for women attaining age 65 before 1978 than for men with identical earnings records. Equal treatment prevails subsequently.

TABLE 2.—ASSUMED FUTURE ANNUAL INCREASES IN WAGES AND IN CONSUMER PRICE INDEX

[In percent]

Year	Average annual wage ¹	Consumer Price Index
1975	9.3	9
1976	8.6	8
1977	8.4	7
1978	7.5	6
1979	6.0	5
1980	6.0	4
1981 and after	5.0	4

¹ See footnote 1, table 1.

TABLE 3.—COMPARISON OF PIA'S UNDER PRESENT LAW AND UNDER 2 POSSIBLE BENEFIT FORMULAS TO BE USED WITH A WAGE-INDEXED EARNINGS RECORD, PERSON ATTAINING AGE 65 AT BEGINNING OF 1976 AND RETIRING THEN

Earnings record	Present law	Formula A	Formula B	Present law as percent of—	
				Formula A	Formula B
MALE WORKER ¹					
Maximum-----	\$364.00	\$375.40	\$359.90	97.0	101.1
125 percent of average-----	343.90	360.50	350.96	95.4	98.0
Average-----	304.70	311.50	305.00	97.8	99.9
75 percent of average-----	253.30	254.80	252.60	99.4	100.5
50 percent of average-----	198.60	198.10	198.90	100.3	99.8
25 percent of average-----	145.60	141.30	145.80	103.0	99.9
FEMALE WORKER					
Maximum-----	378.80	379.40	364.90	99.8	103.8

¹ Also applicable to females or male worker attaining age 62 at end of 1975 and retiring at beginning of 1976.*Description of formulas*

Formula A—100% of first \$123 of AIME, plus 31% of excess.

Formula B—100% of first \$131 of AIME, plus 29% of next \$800 of AIME, plus 10% of excess.

NOTE.—When Formula A or B produces a lower figure than present law, the savings clause would apply, and the larger amount would be payable.

The alternative earnings assumptions are as follows: (1) maximum creditable earnings in all past years back to 1951; (2) same earnings in each year as the average earnings in covered employment in the year (see Table 1); and (3) various multiples (25%, 50%, 75%, and 125%) of such average earnings in each year. In other words, steadily employed workers at various earnings levels are being considered. It will be noted that, as mentioned previously, there is relatively little difference between the maximum case and the 125% case at the present time, but that eventually the maximum case is, in essence, a 161% case.

Table 3 shows that Formula B much more closely duplicates the benefits under present law for the average and higher earnings cases than does Formula A, which produces amounts that are significantly too large. For the 70%-of-average and the 50%-of-average cases, both formulas closely approximate the PIA under present law. Then, for the 25% case (an AIME of \$182), Formula A is significantly too low as compared with present law, while Formula B is a close fit. Of course, for AIMEs of \$123 or less, the two formulas produce the same result.

It would thus appear that, in the immediate future, Formula B produces better results in approximating what present law would do than does Formula A. Moreover, the latter has the undesirable features of producing relatively too large benefits at the highest earnings levels and too small benefits at the lowest earnings levels relative to what present law would do. On the other hand, Formula B produces results that closely approximate what present law would do at all earnings levels except the very lowest ones, where it results in slightly larger benefits—a not undesirable effect from a social viewpoint. Clearly, Formula B is much preferable to Formula A.

Before looking at how the formulas would operate in long-distant future years, let us see how smooth a junction occurs for persons with identical earnings records

but attaining retirement age just before the end of a year and just afterward, since they will have different Computation Years and thus different benefit formulas (because the dollar figures therein will change).

Let us consider a man with average earnings in all past years who attains age 62 at the end of 1976 and retires at the beginning of 1977, as compared with a similar man who attains age 62 at the beginning of 1977. The first man will have 1975 as his Computation Year, while the second man will have 1976 as his Computation Year. The benefit formula for the first man (using the approach of Formula B) will be: 100% of the first \$131 of AIME, plus 29% of the next \$800 of AIME, plus 10% of the excess of the AIME over \$931. The benefit formula for the second man, assuming that wages rise by 9.3% in 1975 over 1974 (as in Table 2) will be: 100% of the first \$143 of AIME, plus 29% of the next \$874 of AIME, plus 10% of the excess of the AIME over \$1,017.

At first glance, it would appear that the first man is at a disadvantage as compared with the second one, because the latter's formula will produce larger amounts for AIMEs in excess of \$131. There are, however, two offsetting factors for the man having Computation Year 1975. First, he receives the automatic CPI benefit increase that was effective for June 1976 (both men receive such increase effective for June 1977). Second, he will have a slightly higher AIME due to the "substitution of high earnings in and after the year of attaining retirement age" provision, as affected by the fact that such earnings are not indexed back to the Computation Year (as mentioned in the previous section).

Let us see how this actually works out for these two men. Assume that the automatic benefit increase for June 1976 is 7.3% (probably low as compared to what will actually occur, but selected so as to have what some consider to be the "normal" differential between wage increases and CPI increases).

The man with Computation Year 1976 will have an AIME of \$799 (1.093 times \$731—see Table 5). Accordingly, his PIA will be \$333 (100% of \$143, plus 29% of \$656); his actual benefit will be 80% of his PIA.

The man with Computation Year 1975, who has 20 computation years, had monthly earnings of \$799 in 1976 and indexed earnings of \$731 for all previous years. Thus, his AIME is \$734 (19 years at \$731 and 1 year at \$799). Accordingly, his initial PIA is \$305 (100% of \$131, plus 29% of \$603). But his PIA for January 1977 will be \$328 (\$306 times 1.073). Thus, the PIA for the man attaining age 62 at the end of 1976 will be only 1½% lower than that of the man attaining age 62 at the beginning of 1977 (\$328 vs \$333). This is certainly a very good junction and consistency.

Now, let us see how the two proposed benefit formulas for a wage-indexed earnings record will operate in the long-distant future as compared with what would happen under present law. Such analysis must necessarily be based on certain economic assumptions for the future. Such assumptions are selected, for illustrative purposes, as 4% annual increases in the CPI and 5% annual increases in earnings over the long range, with somewhat larger increases in the next few years (see Table 2). Later, analysis will be made for an alternative of 3% as the annual CPI increase.

It should be noted that the CPI changes assumed have no effect on the analysis for the two proposed benefit formulas applicable to a wage-indexed earnings record, since we are dealing only with the initial PIA. On the other hand, the CPI changes assumed do have an effect in the computations for present law.

Some might argue that having only a 1% differential between wages and prices is too small. However, this has been done to point out more vividly the instability effects of the present benefit formula under economic conditions which are unfavorable to the financing status of the OASDI system.

Table 4 shows the PIAs resulting for the several earnings-levels cases for persons attaining age 62 in 1994 and 2010. The dollar figures are, of course, surprisingly high in relation to the current level of benefits (as shown in Table 3). The important thing, however, is the comparison of the results under the three benefit methods for each of the various earnings levels.

The present benefit method produces, for these cases, PIAs that, in general, are about 20–30% higher than under either of the two proposals for the 1994 case and as much as 40–65% higher for the 2010 case. The differential is about the same for both formulas for earnings records below the "average earnings" case. But—as would be anticipated—there is an increasingly larger differential of present law over the proposed formula and for Formula A over Formula B as the earnings level rises.

TABLE 4.—COMPARISON OF PIA's UNDER PRESENT LAW AND UNDER 2 POSSIBLE BENEFIT FORMULAS TO BE USED WITH A WAGE-INDEXED EARNINGS RECORD, PERSON ATTAINING AGE 62 AT CERTAIN FUTURE DATES AND RETIRING THEN, BASED ON ECONOMIC ASSUMPTIONS IN TABLE 2

Earnings Record	Present law	Formula		Present law as percent of—	
		A	B	Formula A	Formula B
Person attaining age 62 at beginning of 1994:					
Maximum	\$1,256	\$1,117	\$1,010	112	124
125 percent of average	1,144	981	954	117	120
Average	1,035	836	818	124	127
75 percent of average	906	684	676	132	134
50 percent of average	677	532	533	127	127
25 percent of average	441	380	391	116	113
Person attaining age 62 at beginning of 2010:					
Maximum	3,303	2,651	2,275	125	145
125 percent of average	3,006	2,156	2,096	139	143
Average	2,763	1,824	1,786	151	155
75 percent of average	2,463	1,492	1,476	165	167
50 percent of average	2,068	1,160	1,165	178	178
25 percent of average	1,392	829	855	168	163

Description of Formulas

For 1994, Formula A—100% of first \$330 of AIME, plus 31% of excess.

For 1994, Formula B—100% of first \$351 of AIME, plus 29% of next \$2,145 of AIME, plus 10% of excess.

For 2010, Formula A—100% of first \$720 of AIME, plus 31% of excess.

For 2010, Formula B—100% of first \$767 of AIME, plus 29% of next \$4,683 of AIME, plus 10% of excess.

Table 5 places the analysis of Table 4 in a somewhat clearer frame by showing how the PIAs presented in Tables 3 and 4 relate to the last earnings of the individual. As would be anticipated, for the 1976 case, the benefit ratios for a given earnings level are about the same for all the three formulas.

What is important is how, for a particular formula, these benefit ratios change over the years. With the exception of the maximum-earnings case, these ratios are relatively unchanging for the two proposed formulas, a desirable thing both from the standpoint of adequacy and equity of benefit design and from the standpoint of financial stability. On the other hand, under the present formula, these ratios rise significantly, and to unreasonable heights—reaching 60% or more in a number of cases.⁹

For the maximum-earnings case, under the two proposed formulas, the benefit ratios rise in future years, as more and more years of earnings at the relatively higher earnings bases applicable after 1973 are included. However, such increases are much smaller for Formula B than for Formula A, and thus the former is preferable, because it seems desirable not to favor the very highest paid unduly in changing to an indexing procedure. In fact, Formula B produces results which are not too different from the current 31% ratio.

Table 6 presents the same data and analysis as shown in Tables 4 and 5, but for an ultimate assumed CPI rate of increase of 3% per year instead of 4%. The resulting PIAs for the two proposed formulas remain unchanged, but those for the present law are, of course, lower. Accordingly, the comparisons of the results under present law with those under the proposed formulas are less insidious (i.e., the PIAs under present law do not rise to as undesirably high levels). However, the conclusions drawn previously as to the necessity of changing over to an earnings-indexed approach from the present procedure and as to the superiority of Formula B over Formula A still hold true.

⁹ A PIA benefit ratio of 60% means that a married man retiring at age 65 with a wife the same age who is not eligible for a benefit in her own right would have a total family benefit of more than his last take-home pay, after taxes.

TABLE 5.—COMPARISON OF PIAs UNDER PRESENT LAW AND UNDER 2 POSSIBLE BENEFIT FORMULAS TO BE USED WITH A WAGE-INDEXED EARNINGS RECORD, PERSON ATTAINING AGE 62 AT CERTAIN FUTURE DATES AND RETIRING THEN, BASED ON ECONOMIC ASSUMPTIONS IN TABLE 2

Earnings record	Earnings in year before retirement	PIA as percent of final earnings		
		Present law	Formula A	Formula B
Man attaining age 65 at beginning of 1976: ¹				
Maximum.....	\$1, 175	31	32	31
125 percent of average.....	889	39	41	39
Average.....	731	42	43	42
75 percent of average.....	548	46	46	46
50 percent of average.....	365	54	54	54
25 percent of average.....	182	80	78	80
Person attaining age 62 at beginning of 1994:				
Maximum.....	2, 868	44	39	35
125 percent of average.....	2, 429	47	40	39
Average.....	1, 961	53	43	42
75 percent of average.....	1, 471	62	46	46
50 percent of average.....	980	69	54	54
25 percent of average.....	490	90	78	80
Person attaining age 62 at beginning of 2010:				
Maximum.....	6, 950	48	38	33
125 percent of average.....	5, 351	56	40	39
Average.....	4, 281	65	43	42
75 percent of average.....	3, 211	77	46	46
50 percent of average.....	2, 140	97	54	54
25 percent of average.....	1, 070	130	77	80

¹ Also applicable to female or male worker attaining age 62 at end of 1975 and retiring at beginning of 1976.

Note: Description of formulas: See table 4.

TABLE 6.—COMPARISON OF PIAs UNDER PRESENT LAW AND UNDER 2 POSSIBLE BENEFIT FORMULAS TO BE USED WITH A WAGE-INDEXED EARNINGS RECORD, PERSON ATTAINING AGE 62 AT CERTAIN FUTURE DATES AND RETIRING THEN, BASED ON ECONOMIC ASSUMPTIONS IN TABLE 2, EXCEPT THAT ULTIMATE CPI INCREASES ARE 3 PERCENT PER YEAR

Earnings record	PIA under present law as percent of		PIA under present law as percent of	
	Amount	final earnings ¹	Formula A	Formula B
Person attaining age 62 at beginning of 1994:				
Maximum.....	\$1, 110	39	99	110
125 percent of average.....	1, 012	42	103	106
Average.....	916	47	110	112
75 percent of average.....	801	54	117	118
50 percent of average.....	598	61	112	112
25 percent of average.....	389	79	102	99
Person attaining age 62 at beginning of 2010:				
Maximum.....	2, 539	37	96	112
125 percent of average.....	2, 295	43	106	109
Average.....	2, 096	49	115	117
75 percent of average.....	1, 865	58	125	126
50 percent of average.....	1, 497	70	129	128
25 percent of average.....	1, 054	99	127	123

¹ See table 5 for such earnings.

Note: Description of formulas: See table 4.

COMPUTATION OF PIAs FOR CPI-INDEXED EARNINGS RECORD

If the earnings record is indexed by the CPI, rather than by a wage index, it will be converted to a so-called "real wages" basis. A benefit formula similar to those developed in the previous section can be developed for the CPI-indexed AIME.

The formula that mostly closely seems to fit the situation for a male retirant who attains age 65 at the beginning of 1976 is as follows: 100% of the first \$132 of AIME, plus 32½% of the next \$693 of AIME, plus 10% of the excess of the AIME over \$825.

The AIME for this case for maximum creditable earnings in all years back to 1951 is \$858, while that for a person with average earnings is \$685 and that for a person with 125% of average earnings is \$816 (after allowing for the fact that in most years this 125% level was above the maximum creditable).

A comparison of the resulting PIAs is shown in Table 7 for various earnings levels. It can be seen that not nearly as good a fit with the benefits arising is possible as was the case for the wage-indexed approach.

The question is next raised as to how this formula would be modified in the future as wages and/or prices change. The author sees no good and logical solution to this problem because the CPI-indexing approach mixes the two elements of prices, and wages, and these can only be reconciled for a given point in time. The diverse possible trends of these two economic elements would seem to make it impossible for a specific method of PIA computation to be adopted that would hold up for a long period.

For example, consider the situation under the unlikely (but not impossible or unreasonable) economic assumptions of no future increases in the CPI and also no wage increases. Under these circumstances, the computed CPI-indexed AIME's would increase (unlike the situation for the wage-indexed AIME's, except for a small effect in this direction for the very highest-paid individuals, whose maximum taxable earnings have increased so drastically in 1973 and thereafter). Then, the resulting PIAs from the weighted benefit formula would also increase, and this would be an illogical result under the assumed economic circumstances—namely, why should the ratio of benefits to earnings rise over the years when the level of most recent earnings before retirement remained at the same level?

Perhaps, further research in this field will bring forth a suitable, practical method. (It should be noted that the panel of the Senate Finance Committee talked in only general terms about the benefit computation procedure under a CPI-indexing approach.)

In any event, the author believes that the proper concept for OASDI is that the benefit level at initial determination should, for the steady worker, bear some reasonable relationship to his recent earnings and also to his previous earnings level relative to other workers. This can best—and perhaps only—be accomplished by a wage-indexing approach. To use CPI-indexing (or "real wages") would seem to produce results that could be inconsistent or socially unjust.

TABLE 7.—COMPARISON OF PIAs UNDER PRESENT LAW AND UNDER POSSIBLE BENEFIT FORMULA TO BE USED WITH A CPI-INDEXED EARNINGS RECORD, MAN ATTAINING AGE 65 AT BEGINNING OF 1976 AND RETIRING THEN

Earnings record	Present law		Proposed formula		Present law as percent of proposed formula
	Amount	Percent	Amount	Percent	
Maximum.....	\$364.00	(31)	\$360.30	(31)	101.0
125 percent of average.....	343.90	(39)	352.30	(40)	97.6
Average.....	304.70	(42)	311.80	(43)	97.7
75 percent of average.....	253.30	(46)	256.20	(47)	98.9
50 percent of average.....	198.60	(54)	200.30	(55)	99.2
25 percent of average.....	145.60	(80)	144.70	(80)	100.6

Description of Formula

100% of first \$132 of AIME, plus 32½% of next \$693 of AIME, plus 10% of excess.

NOTE.—Figures in parentheses are PIA as percentage of final earnings (see Table 5 for such earnings).

BENEFIT ADJUSTMENTS AFTER INITIAL DETERMINATION

As to the adjustment of benefits after the date of initial determination (i.e., age 62 for retired workers, year of disablement for disabled workers, and year of death for survivor benefits), there is really little problem of the best procedure to follow.

Certainly, for those cases where benefits are payable immediately and then continuously in the future (until death or other cause of termination), the straightforward, simple procedure of CPI adjustments (as in present law) seems desirable and feasible. This would also be so for survivor benefits payable immediately—e.g. to a widowed mother and children or to a widow aged 60 or over.

The only problem is when the benefit is deferred for some years in the future—e.g. for a woman widowed at age 40 who will first get benefits at age 60 or a widowed mother whose benefits cease for a few years after her children have attained age 18, and she is still well below age 60. One approach, and the author believes it to be best, is merely to adjust the PIA on which the survivor benefit is based for changes in the CPI from year of death of the insured worker to the year when the widow is first to receive widow's benefits.

Another approach is to adjust the PIA for changes in the earnings level during the period from year of death of the worker to the first year of benefit receipt. The author does not believe that this is a desirable approach because it produces undesirable inconsistent results in the benefit basis for a widow who receives mother's benefits until just a short time before she is eligible for widow's benefits.

BIBLIOGRAPHY

1. Myers, Robert J., "Social Security's Hidden Hazards," *Wall Street Journal*, July 28, 1972.

2. Rettig, Albert and Nichols, Orlo, "Some Aspects of the Dynamic Projection of Benefits under the 1972 Social Security Amendments," Actuarial Note No. 81, Social Security Administration, January 1973.

3. Calvert, Geoffrey N., "New Realistic Projections of Social Security Benefits and Taxes," Alexander and Alexander, New York, December 4, 1973.

4. Rettig, Albert and Nichols, Orlo, "Some Aspects of the Dynamic Projection of Benefits under the 1973 Social Security Amendments (P.L. 93-233)," Actuarial Note No. 87, Social Security Administration, April 1974.

5. Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, "1974 Annual Report," House Document No. 93-313, June 3, 1974.

6. Committee on Finance, United States Senate, "Report of the Panel on Social Security Financing," February 1975.

7. Advisory Council on Social Security, "Report," March 1975.

8. Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, "1975 Annual Report," House Document No. 94-135.

Mr. BURKE. Thank you very much, Mr. Myers. We certainly appreciate your appearance here today.

We will recognize Mr. Archer for some questions.

Mr. ARCHER. For you gentlemen who recommend that we go to general revenue financing, will you also tell me what you suggest as a means of raising that revenue?

I assume you don't think we ought to add it onto the national debt with the inflationary impact and everything that will be the result of that, that you would prefer some method of financing here. Would you like to start out, Mr. Brittain?

Mr. BRITTAIN. I would say it would mainly be an increase in the income tax.

Mr. ARCHER. How would you increase it?

Mr. BRITTAIN. In the first place, the earned income credit will be financed out of general revenue. It has already passed. It is accepted that whatever financing that is necessary will take place.

Mr. ARCHER. That was a deliberate tax reduction bill for the purpose of stimulating the economy. I assume in the long-run that this money that is going to come out of general revenue would not be viewed in that category. Therefore, I would like to know what tax you would propose to cover it?

Mr. BRITTAIN. I would suggest that the income tax would be an appropriate substitute for a portion of the payroll tax.

Mr. ARCHER. How would you change the income tax to do that?

Mr. BRITTAIN. I would raise the rates on an across-the-board basis. I do not think that is contrary to the policy of easing taxes at the

present time because you would be giving back offsetting relief to the low-income brackets. In other words, the cut in spending power via the income tax would be offset by an increased spending power in the income ranks that would be getting the benefit of the earned income credit and any other payroll tax offset.

Mr. BURKE. Will you yield at that point?

Mr. ARCHER. I will be happy to yield.

Mr. BURKE. Are any of you gentlemen acquainted with the European countries' tax, one-third on employer, one-third on the employee, and one-third out of the general revenue?

Mr. FELDSTEIN. There is no difficulty raising the revenue.

Mr. BURKE. Let us get down to the specifics. I could give you the answer right off the top of my head by saying let us close the tax loopholes that all the fat cats are enjoying. That can be the answer. I am not going to give you an answer on that.

There are a lot of ways of doing it. I don't think you should expect these gentlemen to come up with specific tax proposals to offset the thing. You and I can slug it out.

Mr. ARCHER. Suffice it to say that we will let Mr. Brittain's response be that he is in favor of raising it through the income tax structure in some way or another.

Mr. BRITTAIN. Including tax reform as the Chairman suggests.

Mr. FELDSTEIN. I don't understand those who want to lower the social security tax rather than lower the income tax burden on those same families. There is a total tax burden distributed in a particular way according to the legislation that Congress has passed. If somebody feels that that total burden is wrong, there is no particular reason to change the structure of the social security tax rather than the structure of the income tax, especially now that the principle of rebatable tax credits has been accepted.

Mr. ARCHER. Let me pursue this a little further with Mr. Brittain.

You are for shifting the tax burden off the worker. Inasmuch as there are only two categories of consumers in our society, the worker and nonworker, what section of the nonworker would you shift it to?

Mr. BRITTAIN. I might say it is shifted off the low-income worker. If you substitute some income tax for the payroll tax, some workers will pay more tax. Other workers will pay less.

Mr. ARCHER. Also a lot of nonworkers pay tax on that basis, too.

Mr. BRITTAIN. That is right.

Mr. ARCHER. You are perfectly prepared to shift part of this burden on the social security recipients themselves to bear a part of the burden? Is that what you are saying? —that they pay a higher cost for bread and for meat and for clothes and all the other things, that is passed on to them through the corporate income tax and the sales taxes and the other types of taxation that are available?

In other words, you are prepared to see part of this burden passed on from the workers to the very people who are benefitting from the social security system?

Mr. BRITTAIN. Part of the burden on the low-income workers would be taken off them and placed on higher income earners.

Mr. ARCHER. Under our economic system it means higher prices on goods so that the people who are drawing the social security benefits, then, begin to pay part of the burden of the system rather than the worker.

Mr. BRITTAIN. There is no need for higher prices if the other kind of tax increases absorb the decrease in the payroll tax.

Mr. ARCHER. Mr. Brittain, the tax is a cost of doing business as any other cost and it has to be passed onto the ultimate consumer. So, the ultimate consumer has to bear the burden. Corporations don't pay taxes. If they can't include in the price of their product the cost of that taxation they go broke. They either pass it on in the price of their product or they go broke. The consumer is the ultimate payer of the taxes.

Basically, I assume what you are saying is that you want the worker to have part of it taken off him and that burden will be passed on in higher prices on the product to the nonworker.

Mr. BRITTAIN. Part of it is passed on by a lag in wages. In other words, if you have an increase in payroll tax, part of the shifting of the tax is in the lag in wages. Part is in higher prices, that is true. But if prices go up, income will tend to go up, also.

What we wind up with is not necessarily a real decline in income. Even if prices go up, that does not necessarily mean a real decline. What you have here is a redistribution of the burden of the tax in real terms if you shift from the payroll tax on low-income workers to paying for that part of social security via the income tax. It is a shift of the burden and not necessarily a shift to consumers as such. It is a shift among income groups. It is a redistribution among income groups, real income groups.

Mr. ARCHER. Mr. Myers?

Mr. MYERS. One point where I would take some difference with Mr. Brittain is that if you do raise income taxes, then it is quite likely that in the future people will have their incomes readjusted to take this into account. In other words, when you increase income taxes sharply in the middle and higher income groups, such persons will insist on more than proportionate raises in salaries and other income.

So you can't say that just because you impose the tax, the apparent initial incidence of it will be the final incidence. A very good example of this is what happened with the Railroad Retirement System. You will recall that originally the Railroad Retirement System was financed by equal employer-employee taxes, but in 1973 the Railroad Brotherhoods, by collective bargaining, got the carriers to bear not 50 percent of the tax, but all of the tax except for the part that was equivalent to the social security employee tax. It would appear that, up to that point, the employers had picked up the tax, and the employees had had their taxes shifted.

What happened was that, in the same collective bargaining agreements, the Railroad Brotherhoods agreed to take a smaller pay increase than they would have been expected to have obtained from the general pattern of wage increases and this just about offset the shift in railroad retirement taxes. Thus, although the appearance of a reduction in the incidence of the railroad retirement tax was given, in actual fact, it didn't occur. The only real gain was to the workers, because of the fact they didn't have to pay income tax on the money that represented the excess of the railroad tax over the OASDI tax. The railroads had the same total cost burden, and of course the Federal Treasury got less income taxes.

Mr. ARCHER. Mr. Myers, let me ask you just one other question generally related to the comparison of the standard level earnings concept and the dynamic earnings concept. Is it possible to have an automatic escalator, which you say you approve, without the dynamic earnings concept?

Mr. MYERS. If I understand your question correctly, cost estimates could be made on either basis, but I think that the automatic adjustment provisions, as we see it now in hindsight—which I think is in this case the final wisdom—are necessary so that the provisions will be able to operate under any dynamic conditions or almost any dynamic conditions.

I think that the proposal which the advisory council has made, and which I have made a bit more specific in my study that I have submitted here, will by and large take care of the situation. But I think there could be extreme, almost impossible, economic conditions where even that would break down.

For example, if prices always increase faster than wages, I think there would still be problems. But certainly there would be much bigger problems for the country as a whole if that situation were to continue.

Mr. ARCHER. Basically, in answer to my question, we could not go back to the standard low earnings concept and have the automatic escalators?

Mr. MYERS. No, I don't believe so.

Mr. ARCHER. Now it fascinated me because the Ways and Means Committee took, I think, something like only 60 minutes or so to pass its new social security program in 1973. The committee accepted the philosophy that inasmuch as we were now on a dynamic earnings concept which was less accurate actuarially than the standard level earnings concept—less accurate we were told at that time from a .1 percent variation in payroll to a .5 percent variation in payroll, plus or minus. The committee adopted the philosophy—and I hope you don't approve this—that inasmuch as the accuracy would gyrate in a wider swing, that you would be less accurate in your projections under dynamic earnings, that you could therefore plan the program on a bigger deficit.

In other words, when we were swinging from .1 percent over to .1 percent under, in accuracy, tolerancy, the committee took the position that they could not design the program that was in deficit more than .1 percent. But when we were told that the swing would be from .5 percent over to .5 percent under, the committee said, well now, it is all right to set the plan up on a deficit of .5 percent. In other words, the majority in Congress adopted the concept that the bigger the inaccuracies in the actuarial projections, the bigger the deficit in the fund they could plan.

Now, since we now find that the actuarial tolerance is no longer .5 percent but is now 5.32 percent, which is 10 times greater than what it was when we took this up in 1973, the committee's logic would be that we could plan a deficit in the fund of 5.32 percent. Now surely you will not say that the Congress acted responsibly when it planned a deficit in the program of .5 percent in 1973 in order to pass on higher benefits without facing up to the taxation burden.

Mr. MYERS. I could agree completely with you on that. I have a great admiration for the Ways and Means Committee. Of course, there

can always be differences of opinion, but I think that, over the years, this committee has certainly been most responsible in its financing of the social security program. I do believe, however, that in 1973, the committee went astray a bit when it said that then .5 percent of payroll is all right as a deficiency OASDI. I think the committee at that point should have continued the .1 percent basis and should have enacted higher tax rates in the law, even though they were not needed currently. At least such higher rates should have been enacted for long-range, as an indication of what is likely to be needed.

In concluding, I certainly agree with you completely that there is no reason for any spread beyond an exact balance, more than a small amount, because this can easily be determined according to the actuarial estimate that the committee is working with at the time. Of course, this procedure is not infallible. The experience can get worse—or better—and the Congress can recognize that when the time comes.

Mr. BURKE. Bob, we have sat in many conferences and had many meetings over the years. You and I know that until they put that cost-of-living escalation in, we didn't have these problems. We sat down every couple of years and we adjusted the ranges. If benefit increases were made, adjustments were made in the taxes to take care of the cost increases.

The way the cost of living has spiraled, prices have spiraled, they just didn't provide for the revenue. That is why we are in the fix we are in.

You remember that when the automatic provisions were put in the law, they thought they were going to restrain Congress. They thought Congress had been too generous. They were going to tie down the increases with that amendment. What has it done? It blew up in their faces. Now we are confronted with some problems.

Mr. MYERS. I agree with you, Mr. Chairman. The main problem now is not the fact that a larger deficiency was planned for in 1973 than had been the case in the past, although I think that it is a factor. I would hope that when the committee gets around to solving this financial problem facing the social security system, as I am certain it will do, then using the actuarial estimates available at that time, it will try to balance up closely the anticipated long-term income and long-term outgo, so that any actuarial balance that is shown will be very close to zero. To put it another way, I hope that you will always "ride way on the wrong side of the road," with a half-percent deficiency or even 1 percent deficiency.

Whatever the financial situation is, you can develop a tax rate, even if it is long deferred in the future, which will eliminate that deficiency and at the same time will give a good indication to the people of the country what the cost of the program is over the long-range.

Mr. STEIGER. Would the gentleman yield?

Mr. ARCHER. I will be glad to yield.

Mr. STEIGER. Are you agreeing with the chairman that the problem is with the automatic cost-of-living adjustment?

Mr. BURKE. The President said if we didn't hold the increase to 5 percent this year, it would cost \$3 billion more. We are faced with a \$3 billion deficit this year. Apparently, the cost of living increase caused a \$3 billion deficit, I would assume.

Mr. STEIGER. You can't look at it in isolation.

Mr. BURKE. It is looking at it the way the Congress used to do. Before that automatic increase was adopted, they proposed an increase but at the same time they proposed the revenue to take care of the increase. Here they took care of the increase and did not propose any revenue to take care of the increase. They didn't think the cost of living would skyrocket the way it did.

As the President said, we ought to hold that deficit down by \$3 billion by holding the increase to 5 percent.

Mr. STEIGER. There was also at one point in that same period a 20-percent increase in benefits.

Mr. BURKE. That is right, but we provided for it with the taxes.

Mr. WAGGONER. That is when we put the escalator in and changed the method of computing taxes.

Mr. BURKE. On a recommittal motion on the floor of the House.

Mr. STEIGER. I still think the escalator makes sense.

Mr. BURKE. It sounded wonderful until the increase came up this year and they said don't let them have the 8 percent increase, it will cause a \$3 billion higher deficit, hold it to 5 percent. The reason it is costing \$3 billion more is that we failed to provide the revenue to pay for the extra 3 percent.

Mr. ARCHER. Mr. Chairman, I intended to desist in questioning but I do want to add one thing that ties in with what you were talking about.

If I remember correctly, the Congress in 1971 and 1972, that one Congress, increased the social security benefits 35 percent. Is that not correct? In one Congress there was a 35 percent increase in benefits. That Congress drove the long-term actuarial projections for the program from .1 percent in deficit to down around .75 percent in deficit because they did not face up at that time to raising the taxes that were needed to cover those politically desirable benefit increases.

I am surprised again, Bob, that you said that was responsible action on the part of the Congress in 1971 and 1972 because I don't consider that to be responsible.

Mr. MYERS. Mr. Archer, I was referring to the enactment of the automatic adjustment provisions themselves, not the 20 percent benefit increase or the reduction in the tax rates at that time.

Mr. ARCHER. By taking that political benefit increase in an election year in 1972 the majority in Congress used up an awful lot of juice in this program and the ability to have an acceptable tax to keep the program on a level keel. Now we are bouncing up against an 11.7 percent total payroll tax which everybody considers to be very, very high and I consider to be high.

Mr. WAGGONER. Will you yield?

Mr. ARCHER. I will be happy to.

Mr. WAGGONER. I think what he is saying is that the cost of living increase on an automatic basis is a far wiser move than our legislating a 35-percent increase in a single year; that if we quit tampering with the program and only take the cost of living increase that the total cost to the program would over the long haul be less. I think that is what he is saying.

Mr. MYERS. That is correct.

Mr. BURKE. But you see, you are dealing with human beings. Those increases that were granted in 1971 and 1972 were increases

on a very small base. Do you know what we are doing in this country? We are penalizing the working people and we chase them right into the graveyard. Now with all this discussion here the European countries have a one-third tax on the employer, one-third on the employee, and one-third out of general revenue.

Mr. WAGGONER. And most of them are broke.

Mr. BURKE. I don't think West Germany is broke and I don't think France is broke and I don't think the Scandinavian countries are broke. They seem to be getting along pretty well.

But what people fail to realize is that the Social Security System has been freighted down with a lot of costs that were formerly paid for by the local town government, city government, State government, and the Federal Government. In fact, one of the city hospitals in this country last year was reimbursed \$17 million for Medicare. Now, if Medicare had not been in existence, since those people were mostly poor people, that \$17 million would have had to have been paid by the property owners of that particular municipality.

So all these things that social security has had freighted down upon it have relieved other taxpayers from burdens that they would normally pay in to the local government, State government, or Federal Government. It is nice for them to sit back and enjoy this wonderful position, but there is some justification for general revenue financing, when you think that the social security trust fund pays for all the buildings of the Social Security Administration. The Federal Government is relieved of all that cash responsibility. They pay for all the equipment and everything else right out of the social security trust fund.

Certainly the Federal Government must have some amount of responsibility. When you consider they borrowed money from the social security trust fund over the years at rates of interest of 2½ percent, I don't know how much we borrowed but I understand it is up around \$350 billion. This is like a big, fat cash register for the Government to go in any day they want and borrow money from.

Actually, the social security trust fund subsidized the Federal Government and the workers of America and the elderly are still paying for that. So, the Federal Government has some moral obligation to replace some of these funds. In fact, if the Federal Government had any moral responsibility at all or felt it, they would send a check over for \$3 billion out of general revenue right now to replace the money they have siphoned out over the years on those low interest rate, 2½ percent loans.

They put a man in jail in this Nation for loaning money to his friends for 1 percent. We have a great system in this country.

The Secretary of the Treasury is manager of the trust fund. He goes in with one hat and borrows a billion dollars. He says to himself, "Can I have a billion dollars?" He answers, "Sure, you can have a billion dollars. How much is the interest?" This is what they did for years. I am not blaming the Secretary of the Treasury. This has happened with all of them.

Mr. ARCHER. This Secretary of the Treasury would wish he could have borrowed some money at 2½ percent interest.

Mr. BURKE. I know he would, and they are going to pay the current rate. No private pension system could stand up over a period of years

getting 2½ percent interest with the escalation in cost of living and escalation in interest rates outside. I don't know what the prime rate is today—7 or 8 percent.

We have had two devaluations of the dollar in the last few years. That alone would wipe out the 2½ percent. The Government ought to go down and pay off the issue and pay them the going rate but they are sitting back and enjoying the wonderful rates they have been getting over the years and the workers of America and the elderly are paying for it.

There is a lot of justification for the Federal Government to come in and pay a share of the social security fund. The Federal Government can't set up these trust funds as they have been doing in the past and just use them as a big cash register to dip their big, fat hands in any time they want. It is very convenient for them. That is what they have done over the years. Now the day is here to pay the bill. We have had a Social Security Subcommittee set up for the purpose of looking into these matters.

I took my first trip down to social security headquarters several weeks ago. I think it is the first time in 18 or 20 years that a member from this committee has gone down there to even look at the plant. This committee is going to look into the financing of social security. We are going to tighten the reins.

Congressman Joe Waggoner is chairman of the Task Force on Financing of Social Security, and let me tell you something about Joe. Joe lifts quarters like they were manhole covers. He is going to tighten the reins down there and make sure the money is spent properly and the fund is properly protected.

Mr. ARCHER. Mr. Chairman, I yield back the balance of my time.

Mr. BURKE. Mr. Jones.

Mr. JONES. Thank you, Mr. Chairman.

Mr. MYERS. I didn't recall whether in your testimony you proposed to take the medicare out of the present trust fund and have it totally funded by general revenues. What is your position on that?

Mr. MYERS. I didn't mention that. My position is very strong on that point. I am opposed to any Government subsidy or Government contribution to the medicare system, particularly the hospital insurance system, which is supported by payroll taxes.

It is true that part "B," or Supplementary Medical Insurance, is financed somewhat more than 50 percent out of general revenues, but I think it is a different kind of program, namely a voluntary insurance program. The only way it can operate successfully is to have money coming in from some other source.

That is why this committee, in this very room, did adopt part "B," incorporating it into the medicare program. It was done on that basis, because that was the only feasible way. I think that if payroll taxes support a social benefit plan, then there should not be Government subsidies involved.

Mr. JONES. What about incorporating medicare into a total health insurance program and take it out of the trust fund?

Mr. MYERS. I think that this would depend on what type of National Health Insurance Program the Congress enacts.

Mr. JONES. If you took medicare out, would that offset the need for a 1 percent increase in the immediate future?

Mr. MYERS. No, because, at the present time, the hospital insurance portion of medicare is very closely in balance. In other words, it is just about adequately financed and it has no great surpluses in it from a long-range standpoint.

Mr. JONES. The 1 percent increase that you recommend in taxes, one-half by the employer, do you have any idea of what effect that would have on small business?

The chairman has mentioned many times the small businessman in New England going broke with all these taxes. I get, from my district, a request for relief. Would this additional burden have any effect on small businesses?

Mr. MYERS. Quite obviously it would have some effect. I just hope that it would have a minimal effect. However, any other way of financing, either by raising the earnings base or by Government subsidy, would, in the end, come back on the small businessman in more or less the same manner. This would mean that he possibly would have to raise his prices somewhat.

Mr. JONES. None of you touched on the question of the earnings limitation. Do any of you support repeal of the earnings limitation or raising of the earnings limitation under the present system?

Mr. FELDSTEIN. I would strongly argue against it for just the kind of savings I mentioned in my statement before. To take the group between \$14,000 current limit and \$24,000 current limit—

Mr. JONES. I am talking about the earnings limitation where they can earn up to \$2,500 and anything over this you are being penalized with your social security benefit.

Mr. FELDSTEIN. I would propose eliminating it.

Mr. MYERS. I guess I am a status quoer, but I think that the present earning test is a very good one, a very equitable one. It has problems, but I think it does about the best that can be done.

I would not agree with the Advisory Council in the change they recommend, in which they propose liberalizing the test in some ways, but cutting it back in other ways.

Mr. BRITAIN. I would say that at the present time, when there is great concern about benefits getting higher and higher and taxes not high enough, it is anomalous that the retirement test is rather stringent.

I am not saying liberalizing the retirement test would solve that problem by getting enough people to work longer. Liberalizing the retirement test would get people to work somewhat longer, but it probably would not make up for the revenue lost. However, insofar as there is an attempt to attack the financing problem by keeping people at work longer—so that they will pay taxes longer and start benefits later—liberalizing the retirement test would be in keeping with that objective.

Mr. JONES. Mr. Feldstein, from your testimony, it appears that your conclusions to the effect that the social security system on capital accumulations are based on the assumptions that in the absence of the social security program everyone would save more and at least save equivalent to their social security benefit, and I am not sure that that is a realistic assumption.

It seems to me that many individuals would not save, indeed, would be increasing the welfare programs. What do you say about that?

Mr. FELDSTEIN. The first set of numbers that I offered to you, when I talked, were based, as you indicate, on the assumption that it is just

a complete substitution for private savings. Then, as I went on to say, there are, of course, individuals who wouldn't have saved anyway. Therefore, it is not a full substitution.

It presented some empirical estimate, based on statistical studies rather than on the conjecture of substitution. You find, then, that there is not full substitution, but it is really quite close, about 75 percent.

Therefore, the numbers that I talked about toward the end of my statement were based on actual statistical estimates of the impact of social security on savings' behavior. I am not suggesting, of course, that one do away with social security, but rather that we have an offset, a change in the program, to accumulate a surplus in the public sector to offset this reduction in private savings.

Mr. JONES. I want to get back to your capital fund, but I wanted to ask Mr. Myers—he mentioned about the offset for other Government programs—would you include veterans' pensions in that, the same kind of offset you mentioned?

Mr. MYERS. Yes; I would. That is what is done in connection with the Prouty amendment.

Most people getting veterans' pensions are going to have OASDI benefits, too. The offset would apply only to dependents' benefits, not to primary benefits.

For example, a man who was working under civil service retirement all his life—maybe he had a veteran's pension, too—could not also receive a husband's benefit from his wife's social security earnings.

Mr. JONES. That would not have anything to do with the problems raised yesterday of an additional problem to the fund, where a Federal worker works all his life or her life and gets the civil service retirement, and then works a few years in the private sector and gets the social security? One of the gentlemen raised that as a potential problem we have to deal with. What would you do in that situation?

Mr. MYERS. I agree that that is a problem. I am very much in a "glass house" in this respect, because I am in that situation, myself. I am receiving a civil service retirement pension. I will also receive social security benefits of a fairly good size, based on some employment I had while a Government employee and on my present employment.

Certainly, what should be done to remedy that general situation would be to include all civil service employees under social security. After all, if the Government has told private employers that, even if they had a pension plan, they had to be under social security, the Government ought to do the same thing for its own employees.

The second solution, if the first is not possible, would be to eliminate the minimum payment provision under OASDI. As you know, there is now a relatively high minimum, which in June will be \$101.40. But that minimum should be eliminated, or at least frozen, so that somebody who just barely qualifies for the minimum now, with very negligible wages, would no longer get such a high minimum.

Mr. JONES. You would have to eliminate that minimum in relation to the total pension benefits to that pension, not totally eliminate the minimum—

Mr. MYERS. Or you freeze the minimum at \$101 so that in the future, as wages and benefits rise it would, in effect, be eliminated. I

think that the real answer would be to cover Federal employees under social security, as administrations going back for many years have wanted to do. But there has been no real pressure for such action, and there has been all the pressure of the Federal employee groups against it.

Mr. JONES. One last question.

Mr. ARCHER. Jim, before you get off that, what other groups are there of any size other than the Federal employees that fit in this category?

Mr. MYERS. The only other group of any real magnitude is State and local government employees who are not under social security. As you know, such persons are covered on an elective basis, if the State or local government wants them to be covered, and in some cases, if the employees so vote. About two-thirds of the State and local employees in the country are under social security.

The other one-third are not. How that problem can be solved considering the constitutional difficulties, is rather difficult. About the only way it could be solved is to cover them compulsorily on the part of the employee, because you can tax the employee, as is done for income taxes, even though the State and local government itself cannot be taxed unless it agrees to do so.

Mr. STEIGER. Can I ask Mr. Calvert if this is the thing to which he referred in his testimony—a universal coverage to put a stop to the abuses of the system?

Mr. CALVERT. That is what I was talking about.

Apart from State and Government employees, there are some non-profit institutional employees, too, who are in the same position, but that is the point I was making.

Mr. MYERS. In the nonprofit area, the extent of noncoverage is relatively small as compared to these other two categories. I think that probably 95 percent of the nonprofit employees are covered.

Mr. CALVERT. That is true.

Mr. ARCHER. Are teachers a category that fall in part of this?

Mr. MYERS. In general they are. In every State, teachers have a retirement system. In some States, teachers are under social security as well as having their own plan. Other States have only their own plan which, of course, has much larger benefits and not social security.

Most of these schoolteachers, being married women, will generally have an advantage in not being under social security and instead receiving their full schoolteacher pension and then also a full wife's benefit from their husband's earnings record.

Mr. CALVERT. Some State and local government groups are considering withdrawing, and that question is in the air in quite a few places; should they stay under social security, or should they get out of it.

Mr. JONES. Professor Feldstein, on your capital fund, explain more about that. What would you do with it?

Mr. FELDSTEIN. Perhaps the best place to begin is by looking at what will happen to the tax rate if we don't have a fund. We keep hearing this figure of a 3-percent, 2.9-percent actuarial long-term deficit. That is an average over the life of a 75-year projection. What it means is, a deficit that is small in the beginning and grows through time, so at the end of the forecast period, the rate is expected to go up from an 11.7-percent rate today to a rate of 18 or 22 percent, de-

pending on the calculations. That means that we are really asking the next generation to pay a much higher tax to support us when we retire than we are prepared to pay ourselves. The alternative is that we raise the tax rate right now to some number less than what is projected as the long-term goal. That will return a surplus. We will use that surplus to build up a large fund.

The Social Security Administration would use their surplus fund to buy back Government debt already existing and held out in the market. They would get the full market rate of interest and not some special rate of interest that the Secretary of the Treasury would arrange.

Mr. WAGGONER. Some Members of Congress want to increase benefits 35 percent, again.

Mr. FELDSTEIN. Hopefully, your new formula procedure will act as a check against that. The point is, to use it as a way of buying Government debt that is currently held out in the market and thus providing funds for private investors to invest in the private sector.

The Government would still have to collect taxes to pay the interest. But the interest payments would go to the social security fund rather than to the private investors. Therefore, the social security tax in the future can be lower. We would have a larger capital stock because private investors would invest in real productive investments rather than holding Government debt. It also means that some of the taxes collected by the Government can be used to replace what would otherwise be a higher social security tax.

Mr. BURKE. I would like to ask Dr. Taeuber—I gather from your statement that making these assumptions over a long period is rather perilous.

I notice, for example, it is projected that in the year 2050, a beneficiary would receive up to \$312,000 a year in benefits.

Mr. TAEUBER. I was speaking only of the demographic projections. I will be glad to defer to Mr. Myers on the benefits.

Mr. MYERS. Mr. Chairman, it seems like a fantastic figure to us at this time, but I have no doubt that these figures are correctly computed. This is just what happens when you compound continuously, at high rates of increase in the CPI and wages.

Mr. FELDSTEIN. \$300,000 is measured in the kind of dollar that the people will then have. There is a real point here that is worth making. Even if one abstracts from inflation, if we look at it in current 1975 dollars, just the growth of real wages is going to cause benefits to quadruple over the next 75 years, so that instead of receiving benefits today of \$5,000, a typical family would receive benefits of \$20,000 75 years from now.

One thing that the committee ought to think seriously about is whether the original purpose of the social security program really requires continuing to increase benefits to replace wages when average wages are \$30,000 and \$40,000 per family. If you reduce the replacement rate as income grows over the next century, then, of course, you contribute to capital accumulation.

Mr. BURKE. If the wages are going to increase at that rate, I can't see your argument against increasing that ceiling of \$14,100.

Mr. FELDSTEIN. I expect the ceiling will go up.

It is indexed to go up with real wages. The question is, whether you should raise it now to \$24,000. Real wages will go up at 2 percent a

year. There is a proposal to raise it substantially more now. That is what I rejected.

Mr. BURKE. Mr. Steiger.

Mr. JONES. Mr. Chairman, may I ask Mr. Steiger to yield to ask a difficult question?

Mr. STEIGER. Mr. Brittain, your analysis of social security taxes has been criticized on the grounds that you divorce benefits from taxes.

For example, the person you assigned to earn \$141,000 also has only one-tenth of his earnings counted in computing his benefits or her benefits. Also, you ignore the fact that the social security program weighs benefits in favor of the low wage earner. What do you say to that?

Mr. BRITTAIN. No; I don't ignore that fact, but in the 10 minutes I had, I did not talk extensively about the distribution of benefits. There is no doubt, as I did say then, that on a lifetime basis the expected benefits of low-income people are higher per dollar of contribution than the benefits of high-income people. That is a fact.

In other words, the overall social security package on a lifetime basis is a progressive one in the sense that low-income people get more out of it per dollar than higher income people.

Mr. WAGGONER. But you still want them to get more?

Mr. BRITTAIN. No. Not that. They should pay less tax. You can finance any kind of benefits by any kind of tax structure you wish. We are not financing on exactly a dollar per dollar basis even now.

We have a progressive structure. The tax can be less regressive, particularly with respect to its burden on low income families. I think there is no contradiction between making the tax structure less regressive and leaving the benefits structure alone. This is perfectly acceptable.

Before you go ahead, the point that Mr. Feldstein made about switching to the income tax—reducing the payroll tax rather than reducing the income tax on certain people—is related to the point I am stressing. It is the burden on low-income people who don't pay any income tax which I am stressing.

I think it is perfectly acceptable to relieve them via the earned income credit mechanism. That can be done even though the overall package is a progressive one. The people who are in poverty right now are excused from the income tax on the grounds of inability to pay. I think they should be largely excused from the payroll tax.

Mr. FELDSTEIN. I think Mr. Brittain missed the point I made about rebatable credit. We have now accepted the principle that income tax can include payment back to people in excess of what they pay. We can offset anything we don't like about the distributional impact of the social security tax without changing the fundamental principle that people view that as a compulsory contribution for their retirement.

Mr. JONES. Presently, isn't the regressive nature of the tax offset by the progressive nature of the benefits?

Mr. BRITTAIN. On a lifetime basis. But consider a 25-year-old worker earning \$4,500, with a family of four. He doesn't have to pay any income tax. He is recognized as unable to pay income tax. That man should not have to pay an 11.7 percent payroll tax.

Mr. FELDSTEIN. You said you are willing to let the social security tax stand as it is and use the personal income tax with rebatable credits to achieve whatever income redistribution that Congress wants.

Mr. BRITAIN. That is right.

Mr. BURKE. Take this fellow who makes \$4,500 a year. He is age 25. If he works his whole life, what benefit would he receive? Say, he works every week of his life, he gets 2 weeks off for vacation, he puts in 40 years of payments into social security. Would his benefits equal the benefits that the person would receive who was on welfare for 40 years and reached age 65? Who would get the most money?

Mr. WAGGONER. Mr. Chairman, that is a bad example: assuming anybody is going to work all his life, 40 years, for \$4,500 a year or that anyone would be on welfare for 40 years.

Mr. BURKE. That is what I am trying to point out. It is one of the problems we have with the social security tax. You can be on welfare for 40 years and at the end of 40 years, you will receive more per month than a person who was on a low-paying job for 40 years would get in social security benefits.

Mr. BRITAIN. You are talking about special cases of welfare payments of more than \$4,500?

Mr. BURKE. I am talking about the payments they get on welfare. You can get more money on old age assistance than you do on social security.

Bob, how many people who get social security have applied for the old age assistance to supplement their income?

Mr. MYERS. About 9 to 10 percent of the social security beneficiaries who are age 65 and over are also receiving public assistance under the new Supplemental Security Income program or formerly under the Old-Age Assistance program.

Mr. BURKE. If that person wasn't on social security and draws old age assistance, he receives the same amount of money that the party would receive who receives a social security check, plus the supplemental payment; is that right?

Mr. MYERS. The social security beneficiary would get \$20 more.

Mr. BURKE. We have people in my State who get a social security check every month. They go to the Welfare Department. They apply for old age assistance, and they get a supplementary check.

Mr. MYERS. In your State, there are quite generous provisions in old-age assistance, which go beyond the general average or beyond the Federal level under SSI.

Mr. BURKE. In other words, what I am getting at is, a person can be on welfare for 40 years and arrive at the age of 65. He can receive more from welfare than if he worked 40 years or 45 years at a low-paying job.

Mr. STEIGER. I don't think the welfare person for 40 years would qualify for social security.

Mr. BURKE. No. I say, his old age assistance check is higher than his social security check would be if he had worked for 40 years.

In other words, they are saying to the fellow, "Don't take that menial job. You go on welfare, and you are better off."

Mr. WAGGONER. It would be a good thing to cut out welfare or at least to do away with the abuses of the program. That would help solve the problem.

Mr. BURKE. That is not the answer. What I am trying to get at is, they are penalizing the low-income person and the persons on those menial jobs. You take a look at your metropolitan papers every Sunday. You will see seven or eight pages of want ads, jobs for elevator operators, dishwashers, laundry workers, jobs of that nature. No one will take them.

Mr. STEIGER. Bus them to South Boston.

Mr. BURKE. That is what you want to look at in general revenue. You people think you are saving money at one end, but you are paying it out at the other end.

Mr. STEIGER. Can I ask Bob Myers and also Mr. Young if both of you would be willing to respond to the question that either Bill Archer or Jim Jones got into, and that is, the question of long-range projections. Who said we ought not be in the business of making long-term projections? Is that a good or bad idea?

Mr. MYERS. I think that it would be a very bad idea not to make long-range projections. It is true that the long-range estimates that are made will not be, by any means, precise and will not show exactly what will actually happen. At least, however, they will give a good indication of what the future cost burdens will be.

Accordingly, I think that, as difficult as it is, in good conscience and in prudence, we must continue to make these long-range cost estimates. I am really surprised that the Commissioner of Social Security said that, because I would not have expected it of him, since I think that, generally speaking, he has been quite prudent financially.

Mr. YOUNG. I certainly don't agree that we should not make long-range projections, because that is one of our problems, that we don't look ahead.

The point that I tried to make is that, in making long-range projections, some of the trends we see emerging are so major that we ought to look at their impact beyond the social security system. They are going to affect a lot of other things if those trends actually happen.

For example, you know there was a study a few years ago called "The Population in the American Future," but that never went beyond the year 2000. The really significant trends start to emerge by 2010 and 2025. So, while we don't know if they are right and, in fact, we are almost certain we are going to be wrong, we don't know by how much we ought to make trends and start to do something about what they indicate.

Mr. CALVERT. I would strongly support both Mr. Myers and Mr. Young on this point. I don't see, in a social security system, how you can plan it rationally unless you make long-term projections. There is an implied social contract between generations, as it has been called. If you can't see what lies ahead for the next generation, you can't set the system up so that it would work properly.

Mr. STEIGER. Given the expertise and the perspective that each of you have, there was a recommendation in the last advisory council report which asked for the establishment of what Chancellor Wallis called a nongovernmental ongoing study group to consider a number of specific problems that the advisory committee report refers to on social security. I wonder if each of you would be willing to comment on whether you think that concept is a good idea, or would you, for example, as an alternative, recommend that we create a continuously

operating advisory council staffed separately from the Social Security Administration?

Mr. MYERS. I think that the advisory council proposal is good, but I think that it would be much better to do something along the lines of what you said, and which has also been proposed by Senator Fong for several years. Senator Fong has proposed that there should be an independent commission on social security, functioning really as a permanent advisory council with people who are on the job more or less full time. So, I would strongly support that approach, but I think that what the advisory council said would be desirable.

Mr. CALVERT. I agree with what Bob Myers said on that point. I think the commission or advisory council or body that has to study this thing on a continuing basis should have access to those who have thought to offer from outside the Government from all fields.

You have thinkers in different locations throughout the community. I think, to keep looking at this whole area is very important.

Mr. FELDSTEIN. Right now, we have the Social Security Administration and Office of the Secretary, and we have a staff of this committee and the corresponding staff on the Senate side. The initial reaction might be, well, it is being studied an awful lot. But you really want a different perspective. That is why it is very important that, if you do go the Government route, that it be very carefully divorced from all of the current groups, Social Security Administration, HEW, and those heavily involved in social security policy.

I am more sympathetic to the Advisory Council's original recommendation that this be done on an external basis, at least, from time to time.

Mr. STEIGER. My concern here—the reason I raised it—I must admit, I had no comprehension as to the fact that by and large the Congress—and, I would judge administrations of whatever political party—have not watched carefully this system with the immense part of the American political, social, economic characteristics. I am not sure whether you are right, Dr. Feldstein, on how well can we create a governmental, yet objective independent study.

Mr. FELDSTEIN. I would suggest something like the National Commission on Manpower, which provides a certain amount of detachment from the views that would normally come through the traditional department concerned with those issues. That is the kind of body you want to get.

Mr. CALVERT. I agree.

Mr. STEIGER. That is my model. I am delighted to hear you say that. Let me ask one last question, if I can, to Bob Myers.

You have, I know, from time to time, expressed a concern over the disability program and what, I judge, you would perceive as the deteriorating condition and that you have been involved with a study for this committee and research service on that subject. Would you be willing to share with us how much of a role changing demographics and economic conditions play in the decline experience and whether or not you think the Social Security Administration has proper control over the disability program?

Mr. MYERS. I think that the analysis of the experience of a disability program is very difficult because it is not like determining death

in survivor cases or age in retirement cases, both of which can be measured quite accurately.

Disability is a very tenuous thing. It does tend to be affected by economic conditions, and certainly that has been one reason why the present experience has become so much higher than it was previously.

In my study, which, as you noted, is completed and is to be published shortly, I came to the conclusion that, at least in part, some of the current bad experience was the fault of the Social Security Administration, because it ceased to administer the program as tightly as it had previously.

The SSA looks at only a small sample of the disability cases. I think that this has been a mistake. I think that, although there were no definite directives that said to loosen up the definition, the whole general atmosphere of saying we don't have to review the cases as closely as we did before has spread down through the actual review by SSA and the actual State adjudication of the cases.

I believe that part of the situation could be remedied by returning to the principles that the Congress enunciated when it enacted the program and when it amended the program in 1965 and 1967, as stated in the committee reports.

Mr. STEIGER. Thank you.

I would want to pay tribute to all of the witnesses today. They have been both interesting and incisive and very worthwhile from the standpoint of at least this one member as we go through this learning experience about the social security system.

Thank you, Mr. Chairman.

Mr. BURKE. Thank you, Mr. Steiger.

Mr. Waggonner.

Mr. WAGGONNER. Thank you, Mr. Chairman.

I wonder if you gentlemen would express yourselves—not at the moment to the issue of social security—but the matter of transfer of payments with regard to the budget of the Federal Government and the effect of the transfer of payments. Do you feel that it has had a detrimental effect or worthwhile effect?

Mr. FELDSTEIN. Transfer payments generally?

Mr. WAGGONNER. Yes, sir.

For the moment, I am leaving social security out, everything but social security.

Mr. FELDSTEIN. A mixed blessing, the way we do it now. I think we have welfare in a bit of a mess. Our unemployment insurance system needs substantial overhaul.

Mr. WAGGONNER. Has the principle of the transfer payments contributed to the chaos that we have produced?

Mr. FELDSTEIN. Yes. I am not saying it has contributed more harm than good. I am saying it has contributed harm as well as good.

Mr. WAGGONNER. Does anybody have a contrary view?

Mr. BRITAIN. Transfer of payments has contributed to what?

Mr. WAGGONNER. Has it been detrimental to our overall economic posture and condition of the economy? Has it aggravated the problems of the economy?

Mr. BRITAIN. I don't believe that. I would agree with Professor Feldstein that there are a lot of defects in the welfare system and unemployment insurance. But I would hate to think what life would be without welfare and unemployment insurance.

Mr. WAGGONNER. Can we take it too far?

Mr. CALVERT. Yes; I think so. The general principle is necessary. I don't think you can visualize this kind of economy without such payments. I think there is a question of extent or degree.

Mr. WAGGONNER. You have hit the nail on the head. Our problem is to find out where that point is.

What is the point that we can go without destroying the system?

Mr. BRITTAIN. I would say the earned income credit is preferable, perhaps, to what are explicitly called exemptions from payroll tax. It is preferable because it does not relax the contributory feature of social security to the same extent. Accomplishing the same thing through the earned income credit, rebating most of the tax to low-income people, extending that to people without children—that is a modest reform. It will cost about \$6 billion.

It would be, I think, entirely in keeping with our principles under the income tax that people who do not have the ability to pay a tax should not be asked to pay it. In effect, we would be rebating the social security tax.

Mr. WAGGONNER. Are you going to equate social security taxation with income taxation, the income tax itself?

Are they in principle supposed to do the same, or do you want to change them to make them the same?

Mr. BRITTAIN. I would like to see the income tax structure changed so that indirectly it provides relief from payroll tax for low-income families just as has been done in the case of the earned income credit, but more extensively.

I think the credit should be related to family size. I am willing to keep the two taxes separate even though one indirectly alleviates the problem of the other. The earned income credit alleviates the problem of the heavy tax on low income people for social security.

Mr. WAGGONNER. I was just reminded that I vehemently objected to this principle when we considered the Tax Reduction Act. I did it because I thought we were doing just what you advocated. We were going to start subsidizing the social security system and we were going to start paying benefits without any regard for contributions, which is a total departure from everything that the Federal Government has done in other benefit programs.

Mr. BRITTAIN. I haven't advocated that. I said I would like to see some substantial relief at the low income end of the scale.

I also agree with the notion of the original authors of Social Security that it would not be disastrous to introduce a Government contribution.

Mr. WAGGONNER. You apparently regard the Social Security system as a passive system?

Mr. BRITTAIN. As a passive system?

Mr. WAGGONNER. Yes, sir.

Mr. BRITTAIN. I don't know what that means, actually.

Mr. WAGGONNER. That the transfer of payments is not anathema to it, that is is not contrary to the principle?

Mr. BRITTAIN. Absolutely not. It is going on already under Social Security—the transfer process. The fact is that the people at the low end of the income scale can expect to get back more from what they put in than those at the higher end of the scale.

That degree of progression in the whole package has not undermined the contributory principle. Some people feel it has, but we still have a relationship between earnings and benefits, even though it is not a one for one relationship.

In other words, there is progressiveness in the structure, and there is some transfer—there is income distribution going on under Social Security at the present time. I don't think it has been disastrous. I think it should go further.

Mr. WAGGONER. Do you believe the return from the private pension plan contribution is relatively higher than the return from Social Security?

Mr. FELDSTEIN. In the past, Social Security return has been increasing, as you know, because the program has been expanding. In the future, it will get a return, something equivalent to a rate of interest on average, lower at the top and higher at the bottom, but on average, it will get a rate of return equal to the real growth in wages.

If our population stops growing, that will come down to one-half to 2 percent a year, rather than the much earlier rate of return we would get if we let the funds in real—

Mr. BURKE. You are referring to the Keogh plan, where you can put up \$7,500 a year of wages and be tax exempt?

Mr. WAGGONER. That is an example.

Mr. BURKE. That is tax exempt?

You get a tax exemption from putting away \$7,500.

Mr. FELDSTEIN. Similarly for corporate contributions for individual workers—

Mr. BURKE. I am talking about the Keogh plan. They can put up to \$7,500 away and that is tax exempt. Then, they get interest that is exempt. But the person paying the Social Security tax gets no tax exemption until he starts receiving his benefits.

Mr. FELDSTEIN. He gets even a lower rate of return.

Mr. BURKE. What would you think of exempting the taxpayer from his amount that he pays into the social security taxes?

Mr. FELDSTEIN. Would you tax it at the other end, the way you tax the Keogh receipts when he receives them?

Mr. BURKE. I could consider that if there was an exemption—

Mr. WAGGONER. There is only deferral on the Keogh because you pay it on the other end.

Mr. BURKE. I don't mind taxing social security beneficiaries who have all kinds of outside income. I think there should be some ceiling of exemption on retirement benefits from taxes. If a fellow is getting \$5,000 a year, he has paid his debt to society. I don't think we should chase him all the way to the grave and try to squeeze the last dollar out of him.

Mr. FELDSTEIN. You realize, if you exempted the employees' contribution that would be a substantial benefit to relatively high earning individuals and relatively low benefit to low earning individuals. It would be a regressive tax.

Mr. BURKE. It would be, but we have to give a break some place to this low wage income.

Mr. WAGGONER. It would be for the time being, and it would not be when he paid it on the other end. It would be the reverse for the low income people.

Mr. BURKE. That means instead of paying 11.7 cents, almost 12 cents, on the minimum wage, for every \$2 earned, they are going to extract 12 cents as taxes. They want that to go up to 13 cents, and Bob Myers said that in 1980 it would go up another 1 percent. It will go up to 14 cents and then up to 15 cents on \$2 earned.

I don't think the minimum wage will be increased during the next 2 years. They keep squeezing that low-wage fellow and nobody seems to be concerned about him.

Mr. WAGGONNER. Mr. Chairman, you are too modest to say nobody is concerned. You know, you are concerned.

Mr. Chairman, there is a note here on the list of witnesses. It says, "Continued to Tuesday." You don't mean these same witnesses, do you?

Mr. BURKE. No. Our next meeting will be on May 20, Mr. Waggonner.

Mr. WAGGONNER. Bob, I am one of those people who miss you over in Social Security.

Mr. MYERS. Thank you.

Mr. WAGGONNER. Gentlemen, we could go on and on. I was late getting here. I will take these statements and read them. The chairman did give me a task force assignment on social security financing. Some of the ideas I have scanned and some of the things I have heard, yours, Mr. Feldstein, doctor, whichever it is, interest me about the impact now of the larger increase rather than something gradual to try to help some of these things.

I think we have to look at all of them. I am not one of these people who thinks there is no way to save this system. Some people take that point of view. I don't take that point of view at all. I think we have to use more commonsense than we have.

I don't think we should play politics with this program at every turn. I am one of the few people who voted against the escalator on an automatic basis based on the fact that I didn't think Congress was going to leave it alone. But, thank God, Congress has finally come to the point that we are going to let one of those automatic increases go into effect without something in between over and above that which was intended. And if we can get on that schedule, I do think that we can stabilize this system by doing certain other things.

This is really the thrust of what you are talking about, isn't it?

Mr. MYERS. Yes, Mr. Waggonner; you certainly said eloquently what I would have liked to have said.

Mr. WAGGONNER. This is where we are. I think we can preserve the system.

I am not coldblooded either, Mr. Brittain. I am not totally opposed to transfer of payments. I just can't resolve in my own mind where that point is beyond which you cannot go with regard to the transfer of payments and not erode your tax base—whether it is payroll taxes, income taxes or whatever it is—nor have too few people left to bear the burden.

I don't know where it is. It is one thing at one economic point in time. It is another thing at another point in time. I do agree we have to look at this thing more from the long-range point of view if we are going to provide any stability.

From what I have seen of the statements and what I have heard, you people have been exceptionally candid with your statements. I appreciate that because we need all points of view.

I was just giving my chairman a hard time a moment ago. We have been arguing about that one-third, one-third, one-third. He won't forget it. He is like an elephant; he won't give up.

Mr. BURKE. Off the record.

[Discussion off the record.]

Mr. BURKE. Back on the record.

I want to thank all the members of the panel for being here. You have made a great contribution. I am particularly happy to see our old friend, Bob Myers, back here. It kind of gives us a little stability here.

Mr. WAGGONER. Would you agree that the first principle we ought to be guided by in trying to provide stability for social security is to begin with the assumption that we can't do what they did with railroad retirement?

Mr. MYERS. Yes, indeed.

Mr. BURKE. The committee now stands adjourned until Tuesday, May 20.

[Whereupon, at 4:45 p.m., the subcommittee adjourned, to reconvene on Tuesday, May 20, 1975.]

FINANCING THE SOCIAL SECURITY SYSTEM

TUESDAY, MAY 20, 1975

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The subcommittee met at 10:20 a.m., pursuant to notice, in room H-208, the Capitol, Hon. James A. Burke (chairman of the subcommittee) presiding.

Mr. BURKE. The subcommittee will please come to order.

Today and tomorrow the subcommittee will be hearing from administration witnesses. Today's hearing will be on the general subject matter on which the subcommittee is now focusing, that is the financing of the social security system.

The subject matter of tomorrow's hearings will be the administrative problems that have arisen in connection with the operation of the social security program, a subject matter which can have significant effects on the cost of the program.

Today we have before us as principal spokesman for the administration, the Secretary of Health, Education, and Welfare, the Honorable Caspar Weinberger and Commissioner of Social Security, James B. Cardwell. Also with us are Mr. Stephen Kurzman and Mr. Haeworth Robertson.

Secretary Weinberger, we welcome you here. You may proceed with your testimony.

STATEMENT OF HON. CASPAR WEINBERGER, SECRETARY, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE; JAMES B. CARDWELL, COMMISSIONER OF SOCIAL SECURITY, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE; STEPHEN KURZMAN, ASSISTANT SECRETARY FOR LEGISLATION, DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE; A. HAEWORTH ROBERTSON, CHIEF ACTUARY, SOCIAL SECURITY ADMINISTRATION, DEPARTMENT OF HEALTH, EDUCATION AND WELFARE

Secretary WEINBERGER. Thank you very much, Mr. Chairman. Also accompanying me today is Bruce Cardwell, the Commissioner of Social Security.

I am honored, as always, to have the opportunity to appear before you. I would like to reaffirm at the outset the pledge of complete cooperation that Commissioner Cardwell made when he appeared on May 7 to review the 1975 reports of the trustees. The trustees are the

Secretary of the Treasury, the Secretary of Labor and the Secretary of Health, Education, and Welfare. I am confident that by working together we can solve the financing problems facing social security. Without trying to minimize the seriousness of these problems, I cannot stress emphatically enough my agreement with Commissioner Cardwell that there is certainly no basis for panic or alarm.

The basic financing problems facing the social security program fall into two broad categories—short term and long term. Both have distinctive and different characteristics. Some of the short-term problems can be traced to recent and unexpected changes in employment. This is not a significant factor in the long-term problem. There is, however, one common characteristic that can be found in both. The financing shortfall for both the short and long term can be traced directly to the fact that coverage and benefit levels have been so rapidly increased and earlier financing assumptions, too, have turned out to be inaccurate. Benefits will continue to rise, on into the future.

The administration recognized the income/outgo disparity that began to develop with the enactment of the 1972 amendments. Because benefits have, as a result of the 1972 changes, already begun to outstrip the system's financing provisions, we proposed the 5-percent cap on the 1975 cost-of-living increase. We knew that the higher increase provided for, in law, would be enough to throw the system into the red. If the 5-percent constraint had been adopted by the Congress, over two-thirds of the current year deficit could have been avoided. Over \$2 billion has been added to the total deficit by the refusal of the Congress to adopt the 5-percent ceiling. This \$2 billion differential affects each future year and is a continuing factor in the trust funds' projected deficits.

There is a point that should be made about the relationship between contributions and benefits. We must not permit one of the most important principles of this program to break down—that is, the principle that the program always pays its own way. General revenues should never in any circumstances be relied upon to finance the system. As the members of this committee well know, in the first place, there are no general revenues available for this purpose. There is only an even bigger deficit. Even if there were, however, it is essential to preserve the earned-right principle behind the social security program. Social security is purchased insurance, and is not welfare. The financing of it must preserve this vital characteristic.

If you would now permit me, I would turn to a review of the outlook of the next 75 years—the long term.

The long-range cost estimates indicate that the old-age, survivors, and disability insurance program [OASDI]—the cash benefits part of the social security program—has a deficit of 5.32 percent of taxable payroll over the customary long-range valuation period of 75 years. The major causes of this deficit are: (1) Revised demographic projections based on 1970 Census data which show that the future work force will be considerably smaller in proportion to the number of beneficiaries than was previously anticipated; (2) new long-range economic assumptions of annual increases of 6 percent in average earnings and 4 percent in the Consumer Price Index; and (3) the large and rapid increases in benefit levels that have already occurred (nearly 70 percent in the past 5 years), far outstripping the cost of

living, and the projected future increases in benefit levels relative to earning levels produced by the automatic benefit adjustment provisions of present law under the new economic assumptions.

The hospital insurance (HI) portion of the social security medicare program is in reasonably good shape, with only a slight projected long-range deficit of 0.16 percent of taxable payroll over the customary long-range valuation period for this part of the program of 25 years.

The supplementary medical insurance program [medicare, part B] is also financially sound. However, as you know, the part B premium is permanently frozen at its current rate of \$6.70 because of a technical problem that arose when the timing of automatic benefit increases was changed in legislation enacted in December 1973. Unless this problem is corrected, substantial increases in general revenue supplementation will be required. The Ways and Means Committee has already reported legislation to deal with this problem as part of H.R. 5970, the "Emergency Health Insurance Extension Act of 1975." And I am pleased that the committee has recognized the need for this provision, although in an otherwise undesirable bill. Given the uncertain future of H.R. 5970, I would urge that this legislation be included in any overall corrective legislation regarding social security financing that may grow out of these hearings.

The present law will produce a result in which the outgo will exceed income to the OASDI program beginning this year and continuing into the future, exhausting the reserves in the cash benefits trust funds by the early 1980's. The main causes for this are: (1) Rapid and large benefit increases in the past 5 years; (2) higher than anticipated levels of inflation over the short term which result in higher benefits under the automatic benefit adjustment provisions of present law; and (3) lower levels of employment, which means less income to the program.

Under the present law, income to the hospital insurance program will exceed outgo over the next several years and into the 1980's.

If I could, I would like to devote just a couple of minutes to the long-range situation. First, we fully recognize that it represents a problem that will need to be dealt with, and, I am sure, will be dealt with, at the appropriate time. Second, I would like to put the long-range problems into perspective.

The major adverse effects of the new demographic and economic assumptions on the long-range status of the OASDI program will not be felt for many years to come; indeed, until well into the next century. The projected increase in the ratio of beneficiaries to working people does not rise steeply until about 2010. It does rise steeply after that. But I want to point out to the committee the astonishing fact that if we keep the present automatic benefit adjustment provision, many workers will receive social security benefits that will exceed preretirement earnings, and this will happen shortly after the year 2000. While there is adequate time for careful and thoughtful consideration to deal with the long-range financing problem, there is no gainsaying the fact that we must start that consideration now.

As you know, the 1975 Advisory Council on Social Security recommended changing the social security benefit structure to provide stable and predictable replacement of preretirement earnings. Under this recommendation, benefits, of course, would continue to rise in the

future, but a benefit formula would be developed to assure that replacement rates would be stable so that workers who have the same relative earnings would get the same relative benefits regardless of when they retire. The replacement rates could be the same as they are today, but they would not react capriciously to changing economic conditions, as they would under present law. The President has endorsed this general concept, and we are studying now the various ways of accomplishing this objective.

A benefit stabilization proposal could significantly improve the long-range deficit problem. For example, under the model that you are familiar with, the one set out in the 1975 trustees' report, the long-range deficit could be reduced by almost half, that is, 2.43 percent of taxable payroll. Because of this, a specific method of dealing with the long-range deficit should be postponed until a specific benefit stabilization plan is developed. We are working on precisely this effort right now.

We have a more immediate problem, and that is the short-term deficit facing the OASDI program. The trust fund reserves are currently serving the purpose for which they were intended—to meet temporary situations where income is less than outgo. We must act, however, to assure they will not be depleted in the early 1980's and that they will be maintained at an adequate level to continue to serve their contingency-reserve role and their role in helping to secure public confidence in the financial integrity of the program—a role, I might add, that they are performing right now.

As I have already mentioned, the administration's proposal to put a 5-percent ceiling on this year's benefit increase would have had a beneficial effect on the short-term deficit. We are reluctant to put forward another specific proposal in light of the cavalier disregard our most recent suggestion received. It may be said that limiting benefit increases is unpopular. I can only say that what is even more unpopular is jeopardizing the financial and fiscal integrity of the social security system. I am confident the members of this committee share this view.

I could put the issue quite plainly. There are only three ways to maintain the integrity of the fund. First, we can increase revenues by raising the tax rate. Second, we can increase revenues by extending the wage base on which taxes are collected, or combinations of those two. Third, we can moderate the projected increases in benefits.

The administration's 5-percent ceiling was a modest variation of the third approach. The congressional reaction suggests to us that it prefers some combination of the first and the second. While we do not have a specific tax increase proposal, we would certainly be receptive to congressional initiatives which conform to certain essential principles. We certainly look forward to working with the committee and will provide it whatever technical assistance we can in this very complex area.

The essential principles that I mentioned a moment ago, to which any congressional proposal for an increase in social security taxes should conform, are as follows:

Foremost, because of the current state of the economy, it is our basic position that no tax increases or other social security revenue-producing measures should be adopted which affect calendar year 1975 or 1976. In our view, it is neither necessary nor wise to consider

any change in revenue development that takes effect before 1977. This position is, we believe, entirely consistent with the previously adopted Federal policy calling for actions to stimulate the economy during these years and the avoidance of additional taxes, for whatever purposes.

Any revenue-producing method to be selected—and, as you know, there are several from which one might make a choice—should seek to avoid sudden and sharp rises in either the tax rate or the wage base.

Whatever we do, it should be timed so that the OASDI trust funds are not allowed to fall to too low a level before additional revenue development is provided. This is essential, we believe, if we are to maintain public confidence in the program. As you know, the existing reserve fund will carry us into the early 1980's.

It has been suggested that medicare income not required for the short term, might be used to defray some of the OASDI requirements. While this might be a possible choice for the very short term, I would remind the committee that the trustees' 1975 report shows medicare trust funds as falling into a deficit position over the next 25-year period. Thus, this choice should be approached with caution.

As I have already said, it is utterly impractical to talk about general fund financing as a means of solving the financing problem—because we simply do not have any general funds left. Instead, we have an enormous deficit. I will speak more to my concerns about general revenue financing in a moment.

First, let me review quickly the dimensions of the short-term financing requirements.

If a straight tax increase were adopted as the means of making up the short-term deficit, a total rate as high as 6.50 percent for employees and employers, each, would be required by 1978. This would represent an increase of 0.85 percent of payroll over the present 1975 rate of 5.85 percent, and an increase of 0.45 percent of payroll over the 1978 rate of 6.05 percent already prescribed in existing law. These percentages are on a combined basis and apply to both medicare and OASDI. They also, of course, apply to the employee and the employer.

In considering wage base choices, there are a number of options available, but all would require fairly significant increases over the present level of \$14,100.

As already noted, we would caution against sudden and large increases in the wage base. We believe that it is important to synchronize tax imposition on the group of wage earners that would be most affected by wage base changes—and, for that matter, tax imposition on wage earners generally—with the worker's capacity to increase his productivity and increase his standard of living.

In other words, we should be careful not to diminish his capacity to contribute not just to his own or his family's protection in matters such as social security, but we must also be concerned with his capacity to participate as an important role player in the economy generally, in contributing the savings and all the rest.

Because it cannot be said too many times, I would again note that we see general revenue financing as an especially bad choice. This choice would inevitably result, in our opinion, in the erosion of the earned-right and wage-related principles that are an important part of the basic social security program.

It is our conclusion that it would be only a matter of time, following any shift to general revenue financing in whatever form, before social security would be converted from a social insurance system whose benefits are available only to those who have participated to a general means tested income maintenance program for the elderly.

This should not be taken to imply a lack of concern for the income maintenance needs of the elderly. Just the opposite is true, as is demonstrated in the very large expenditures we make on their behalf each year.

We would meet this concern at this time through the Supplemental Security Income program under existing law, and in the future we should do it through comprehensive income maintenance reforms—reforms that would preserve the social security program as a separate earned-right, earnings-related social insurance program, and move it into a full cash treatment of public assistance, which is another and much longer story.

The matter of income maintenance reform is, of course, an entirely different subject, but it is an important consideration in our thinking about how to best finance social security, both in the short and the long term. Because, if we use social security as a substitute or as a means of bringing about public assistance or income maintenance, then we will be in very serious trouble.

Mr. Chairman, that concludes my prepared statement. I would like to thank the subcommittee for this opportunity to present our position on the financing of social security and will be happy to answer any questions you may have.

[The prepared statement follows:]

STATEMENT OF CASPAR W. WEINBERGER, SECRETARY OF HEALTH, EDUCATION,
AND WELFARE

Mr. Chairman and members of the subcommittee, I appreciate this opportunity to appear before you to discuss the financing problems facing the social security program.

I would like to reaffirm the pledge of our complete cooperation that Commissioner Cardwell made when he appeared to review the 1975 reports of the Trustees for you on May 7. I am confident that by working together we can solve the financing problems facing social security. Without trying to minimize the seriousness of these problems, I cannot stress emphatically enough my agreement with Commissioner Cardwell that there is certainly no basis for panic or alarm.

PROBLEMS

The basic financing problems facing the social security program fall into two broad categories—short term and long term. Both have distinctive and different characteristics. Some of the short-term problem can be traced to recent and unexpected changes in employment. This is not a significant factor in the long-term problem. There is, however, one common characteristic that can be found in both. The financing shortfall for both the short and long term can be traced directly to the fact that coverage and benefit levels have been so rapidly increased and earlier financing assumptions have turned out to be inaccurate. Benefits will continue to rise, on into the future.

The Administration recognized the income/outgo disparity that began to develop with the enactment of the 1972 Amendments. Because benefits have, as a result of the 1972 changes, already begun to outstrip the system's financing provisions, we proposed the 5 percent cap on the 1975 cost-of-living increase. We knew that the higher increase provided for in law would be enough to throw the system into the red. Had the 5 percent constraint been adopted by the Congress, over two-thirds of the current year deficit could have been avoided. Over \$2 billion has been added to the total deficit by the refusal of the Congress to adopt the 5 percent

ceiling. This \$2 billion differential affects each future year and is a continuing factor in the trust fund's projected deficits.

I would like to make one additional point at the outset about the relationship between contributions and benefits. We must not permit one of the most important principles of this program to break down—that is, the principle that the program always pay its own way. General revenues should never in any circumstances be relied upon to finance the system. As the members of this Committee well know, in the first place there are no general revenues available for this purpose. There is only an even bigger deficit! Even if there were, however, it is essential to preserve the earned-right principle behind the social security program. Social security is purchased insurance for retirement, and not welfare. The financing of it must preserve this vital characteristic.

I want to talk more about the relationship of benefits to financing and the matter of general revenues later in my statement with respect to both the short and long-term issues. Permit me now to turn to a review of the outlook for social security financing over the next 75 years—the so-called long-term.

Long-term problem

Long-range cost estimates indicate that the old-age, survivors, and disability insurance program (OASDI)—the cash-benefits part of the social security program—has a deficit of 5.32 percent of taxable payroll over the customary long-range valuation period of 75 years. The major causes of this deficit are: (1) revised demographic projections based on 1970 Census data which show that the future work force will be considerably smaller in proportion to the number of beneficiaries than was previously anticipated; (2) new long-range economic assumptions of annual increases of 6 percent in average earnings and 4 percent in the Consumer Price Index; and (3) the large and rapid increases in benefit levels that have already occurred (about 75 percent in the past six years) and (4) the projected future increases in benefit levels relative to earnings levels produced by the automatic benefit adjustment provisions of present law under the new economic assumptions.

The hospital insurance (HI) portion of the social security Medicare program is in reasonably good shape, with only a slight projected long-range deficit of 0.16 percent of taxable payroll over the customary long-range valuation period for this part of the program of 25 years.

The supplementary medical insurance program (Medicare part B) is also financially sound. However, as you know, the part B premium is permanently frozen at its current rate of \$6.70 because of a technical problem that arose when the timing of automatic benefit increases was changed in legislation enacted in December 1973. Unless this problem is corrected, substantial increases in general revenue supplementation will be required. The Ways and Means Committee has already reported legislation to deal with this problem as part of H.R. 5970, the "Emergency Health Insurance Extension Act of 1975." And I am pleased that the Committee has recognized the need for this provision, although in an otherwise undesirable bill. Given the uncertain future of H.R. 5970, I urge that this legislation be included in any overall corrective legislation regarding social security financing that may grow out of these hearings.

Short-term problem

Under present law, outgo will exceed income to the OASDI program beginning this year and continuing into the future, exhausting the reserves in the cash-benefits trust funds by the early 1980's. The main causes for this are: (1) rapid and large benefit increases in the past 5 years; (2) higher-than-anticipated levels of inflation over the short term which result in higher benefits under the automatic benefit adjustment of present law; and (3) lower levels of employment, which mean less income to the program.

Under present law, income to the Hospital Insurance program will exceed outgo over the next several years and into the 1980's.

Perspectives on long-range OASDI financing

I would like to devote just a couple of minutes to the long-range situation. First, we fully recognize that it represents a problem that will need to be dealt with, and, I am sure, will be dealt with, at the appropriate time. Second, I would like to put the long-range problems into perspective.

The major adverse effects of the new demographic and economic assumptions on the long-range status of the OASDI program will not be felt for many years to come; indeed, until well into the next century. The projected increase in the ratio of beneficiaries to working people does not rise steeply until about 2010.

But I do have to point out to the Committee the astonishing fact that if we keep the present provision, many workers will receive social security benefits that will exceed preretirement earnings, and this will happen shortly after the year 2000. While there is adequate time for careful and thoughtful consideration to deal with the long-range financing problem, there is no gainsaying the fact that we must start that consideration now.

As you know, the 1975 Advisory Council on Social Security recommended changing the social security benefit structure to provide stable and predictable replacement of preretirement earnings. Under this recommendation, benefits of course would continue to rise in the future; but a benefit formula would be developed to assure that replacement rates would be stable so that workers who have the same relative earnings would get the same relative benefits regardless of when they retire. The replacement rates could be the same as they are today but they would not react capriciously to changing economic conditions, as they would under present law. The President has endorsed this general concept, and we are currently studying various ways of accomplishing this objective.

A benefit stabilization proposal could significantly improve the long-range deficit problem. For example, under the model set out in the 1975 Trustees' report, the long-range deficit could be reduced by almost half—that is, 2.43 percent of taxable payroll. Because of this, a specific method of dealing with the long-range deficit should be postponed until a specific benefit stabilization plan is developed. We are working on precisely this effort now.

Proposed solution to short-range financing problem

A more immediate problem is what to do about the short-term deficit facing the OASDI program. The trust fund reserves are currently serving the purpose for which were intended—to meet temporary situations where income is less than outgo. We must act, however, to assure they will not be depleted in the early 1980's and that they will be maintained at an adequate level to continue to serve their contingency-reserve role and their role in helping to secure public confidence in the financial integrity of the program.

As I have already mentioned, the Administration's proposal to put a 5 percent ceiling on this year's benefit increase would have had a beneficial effect on the short-term deficit. We regret very much the Congress's inaction concerning it. We are reluctant to put forward another specific proposal in light of the cavalier disregard our most recent suggestion received. It may be said that limiting benefit increases is unpopular. I can only say that what is even more unpopular is jeopardizing the fiscal integrity of the social security system. I am confident the members of this committee share this view.

Let us put the issue quite plainly. There are only three ways to maintain the integrity of the fund. First, we can increase revenues by raising the tax rate. Secondly, we can increase revenues by extending the wage base on which taxes are collected. Thirdly, we can moderate the projected increases in benefits.

The Administration's 5 percent ceiling was a modest variation of the third approach. The Congressional reaction suggests to us that it prefers some combination of the first and the second. While we do not have a specific tax increase proposal, we would be receptive to Congressional initiatives which conform to certain essential principles. We look forward to working with the Committee and will provide it whatever technical assistance we can in this complex area.

The essential principles to which any Congressional proposal for an increase in social security taxes should conform are as follows:

Foremost, because of the current state of the economy, it is our position that no tax increases or other social security revenue producing measures should be adopted which affect calendar years 1975 or 1976. In our view, it is neither necessary nor wise to consider any change in revenue development before 1977. This position is, we believe, entirely consistent with the previously adopted Federal policy calling for actions to stimulate the economy during these years and the avoidance of additional taxes, for whatever purpose.

Any revenue producing method to be selected—and, as you know, there are several from which one might make a choice—should avoid sudden and sharp rises in either the tax rate or the wage base.

Whatever we do, it should be timed so that the OASDI trust funds are not allowed to fall to too low a level before additional revenue development is provided. This is essential, we believe, if we are to maintain public confidence in the program.

It has been suggested that Medicare income not necessarily required for the short term might be used to defray some of the OASDI requirements. While this

might be a possible choice for the very short term, I would remind the Committee that the Trustees' 1975 Report shows Medicare trust funds as falling into a deficit position over the next 25-year period. Thus, this choice should be approached with caution.

As I have already said, it is utterly impractical to talk about general fund financing as a means of solving the financing problem—because we simply do not have any general funds left. Instead, we have an enormous deficit. I will speak more to my concerns about general revenue financing in a moment.

First, permit me to review quickly the dimensions of the short-term financing requirements.

If a straight tax increase were adopted as the means of making up the short-term deficit, a total rate as high as 6.50 percent would be required by 1978. This would represent an increase of .65 percent of payroll over the present 1975 rate of 5.85 percent, and an increase of .45 percent of payroll over the 1978 rate of 6.05 percent already prescribed in law. These percentages are on a combined basis and apply to both Medicare and OASDI. They also, of course, apply to both the employee and the employer.

In considering wage base choices, there are a number of options available, but all would require fairly significant increases over the present level of \$14,100. As already noted, we would caution against sudden and large increases in the wage base. We believe that it is important to synchronize tax imposition on the group of wage earners that would be most affected by wage base changes—and, for that matter, tax imposition on wage earners generally—with the worker's capacity to increase his productivity and increase his standard of living. In other words, we should be careful not to diminish his capacity to contribute not just to his own or his family's protection in matters such as social security, but we must also be concerned with his capacity to participate as an important role player in the economy generally.

Because it cannot be said too many times, I would again note that we see general revenue financing as an especially bad choice. This choice would inevitably result, in our opinion, in the erosion of the earned-right and wage-related principles that are an important part of the basic social security program.

It is our conclusion that it would be only a matter of time, following any shift to general revenue financing in whatever form before social security would be converted from a social insurance system whose benefits are available to only those who have participated to a general means tested income maintenance program for the elderly. This should not be taken to imply a lack of concern for the income maintenance needs of the elderly. Just the opposite is true. We would meet this concern at this time through the Supplemental Security Income program under existing law, and in the future through comprehensive income maintenance reforms—reforms that would preserve the social security program as a separate earned-right, earnings-related social insurance program. The matter of income maintenance reform is, of course, an entirely different subject, but it is an important consideration in our thinking about how to best finance social security, both in the short and the long term.

Mr. Chairman, that concludes my prepared statement. I would like to thank the Subcommittee for this opportunity to present our position on the financing of social security and will be happy to answer any questions you may have.

Mr. BURKE. Thank you, Mr. Secretary.

You indicate in your statement that there is no need to adjust social security taxes in 1975 and 1976 to meet the short-run deficit.

Secretary WEINBERGER. Not only no need, Mr. Chairman, but it is undesirable to do so because we feel now that the economy needs the stimulation that is already being provided and an additional tax or revenue measure in those 2 years would have an undesirable and possibly depressing effect.

We do think there is a need to begin consideration of the problem now, and a need for action on a proposal that would take effect in 1977.

Mr. BURKE. Won't that result in the deficit going higher?

Secretary WEINBERGER. It would result in an opportunity to correct the problem while there is still ample time to do so.

The reserves that we have in the trust fund will decrease in these years. They will not become exhausted until 1982, 1983, in that range, and therefore there is ample time to take the measures necessary. We will be delighted to work with this committee and the Congress in developing measures to correct that situation well before there is any thought of the reserves being exhausted.

That is why I emphasize at every opportunity that the system is completely sound. It does need some work and needs some problems corrected. While it would be undesirable to put in additional revenue-producing measures in the next 2 years, we should start thinking about and developing those measures, and they should then be enacted, we recommend, to take effect in 1977.

Mr. BURKE. This is a surprising statement. Of course, every Member of Congress will be happy to know that he doesn't have to vote for new taxes. I suppose the administration will be happy to know that they don't have to recommend any new taxes for the next 2 years.

Do you think this will stop people from talking about the large deficits?

Secretary WEINBERGER. Well, sir, proportionately the deficits in the social security system are not all that large. I wish the general budget deficit was in the same order of magnitude. The simple fact there are deficits and that we are drawing down reserves. That is what reserves are for. There is no reason not to use reserves for that purpose.

There are quite a few reasons economically not to take additional funds out of the economy by increased taxation during the next couple of years.

That does not mean, however, we do not need to address the problem. I think that substantial confidence will be given to the whole system when the basic problem is solved.

I think that it would be wrong to put in measures of this kind effective before 1977. By that time we believe the economy will no longer be in the difficult position that it is in now. Again, the need for action is not necessarily deferred. What I am talking about is the effective date of the action. The effective date should not be before 1977.

Mr. BURKE. I think it has been the history of the House Ways and Means Committee in the past to adjust the rates of taxes to meet with the outgo every year. We have done that over the years that I have been on the committee.

It is only recently, since the enactment of the automatic cost-of-living increase, that there is no provision made for raising taxes necessary to pay for the money that is outgoing.

If we have a \$3 billion deficit this year, as predicted by the Commissioner, I believe, and a larger deficit next year, and then we are going to deal with it in 1977, I know that is a popular thing to do with everybody. Everybody would like to be able to tell the people: "We are going to reduce your taxes and increase your benefits."

Secretary WEINBERGER. We don't recommend either course, Mr. Chairman.

Mr. BURKE. The law as written provides the cost-of-living increase next year, and you have that increase on top of the increase that was

granted this year under the law. Yet we have the administration saying that there is no need for any taxes at this time.

Secretary WEINBERGER. The administration proposed a course that would have greatly mitigated the problem. We proposed a 5 percent limitation on the increase. It is symptomatic of the times that it has been characterized as a 5 percent cut in benefits. What it was was a 5 percent increase on top of an increase of nearly 70 percent in the last 5 years, or so, and the Congress did not take action on it. I very much regret that. Had you done so, that would have mitigated the problem very substantially and would have removed the deficit this year. There is still time to do that.

Mr. BURKE. You know, Mr. Secretary, I would like to agree with you, but I don't think anybody down at the White House expected that to take place.

Secretary WEINBERGER. Well,——

Mr. BURKE. We didn't have one member of the subcommittee or the Ways and Means Committee, on either side, who proposed that. We didn't have a member on the minority side of the House who proposed it. No one picked the ball up and carried it for you. It just died the day it went out.

As I say, I think we ought to forget about the past. There have been a lot of mistakes made in the past. I think what we have to do is look to the future. We have to.

Secretary WEINBERGER. I agree. Our statement is focused that way. That is why I referred to the congressional treatment of that proposal as cavalier because it did not get any consideration. I was with the President when he decided that that was what should be done, and I think he intended that very seriously and was very hopeful that it would be enacted. As I say, there is still time to do it. Because the Congress has not enacted it, we are proceeding to get ready for the increase that is required under the law, but we still urge that the law be changed so that that increase be limited to 5 percent, and that would eliminate the deficit this year.

Mr. BURKE. You can't take something away from people once you give it to them. That was the mistake that they made when they adopted the cost-of-living increase and they failed to provide any taxes to pay for those cost of living increases.

Secretary WEINBERGER. I am not arguing that point. The only point I argue, Mr. Chairman, is whether or not it has been "given".

It is not really given until it is in the envelopes. We recommended a change in the formula in January, and there is still time to enact it. That is a feasible way of dealing with the shortrun problem.

Mr. BURKE. I am just shocked that the administration should come down here and fail to make a stronger recommendation than they are making here today. It is going to please every politician in the Capitol and the White House. I know that.

They will find out that they don't have to recommend any adjustment in taxes. I think that one of our responsibilities is that, if we vote for something, we should have courage enough to vote for the taxes to pay for it.

Any demagogue can go out and recommend all kinds of benefits and let them go. This committee is ready to follow the leadership of the administration, if they will come in here and make some recommenda-

tions, but you are not making them. You are saying put everything off until 1977.

Secretary WEINBERGER. Mr. Chairman, if I might make a point, and I don't want to interrupt you, the leadership in the administration was offered. We did say that the way to deal with this problem this year is to hold down the benefit increase.

Benefits have increased nearly 70 percent over the last 5 years. The cost of living has gone up less than 40 percent in that period. Benefit increases have almost doubled that. I agree with everything you said. We said let's have 5 percent more this year, rather than 8 percent, and that would have taken care of the problem this year.

That was the leadership we offered. Congress did not follow that.

It is unwise, economically, to have a tax increase this year or next year because of the state of the economy; it is not unwise to enact something, but it is unwise to have it take effect before 1977. We would still recommend that you enact a limitation on the benefit increase. Even with this limitation benefit increases will be nearly double the increase in the cost of living in the last 5 and a half to 6 years; so no one can say that there has not been sufficient generosity.

As I indicated, there was more than a sufficient increase in benefits but because the proper attention wasn't paid to the revenue side. We say, if you want to go to a revenue increase, we would certainly work with you and give you every assistance. But we feel, frankly, that having sent a proposal up that was treated so cavalierly that it was not even introduced, the next stage is one in which we can do no more than participate, generally, with you in the form of trying to assist you in developing a tax increase.

Mr. CONABLE. Fortunately, Mr. Chairman, we are not dependent on administration leadership here. We can go ahead and raise the taxes if that is what you want to do.

Mr. BURKE. I think it is incumbent upon us to stabilize the social security trust fund, and I don't think we can put it off until 1977, after the 1976 election.

Mr. CONABLE. I am not disagreeing with you, Mr. Chairman.

Mr. BURKE. It has been proposed that we forget it until 1977.

Secretary WEINBERGER. No, sir, Mr. Chairman. We are not saying postpone your action. We say make the effective date of any action you take 1977. The reason we say that is that we think it would be wrong from the point of view of the economy to take more money out of the economy for reserve purposes at a time when all of us—and the Congress more so than the administration—are trying to stimulate the economy.

Mr. KARTH. May I ask, Mr. Secretary, what is your outlook on the economy in 1976? Are you saying we are going to have a bad economy or a good one in 1975?

Secretary WEINBERGER. I follow, basically, the estimate that all of the economists that the administration has assembled believe with a singular degree of unanimity, and that is that, probably, the next few months should see the bottoming of this situation and there should be a fairly steady and, we hope, not too precipitous, improvement, or increase, in the rate of activity of the economy, because we don't want to get back into inflation again. This should run through 1975 and continue on through 1976, but we don't believe that that process

should be tampered with by a tax increase that would be effective before 1977.

We do think the committee should address the problem and that whatever action is taken should be effective in 1977, unless you will follow our proposal and reduce the benefit increase to 5 percent.

Mr. KARTH. If you are concerned about the economy moving upward in 1976, won't this have the effect of making the tax increase effective in 1976?

Secretary WEINBERGER. I am talking about 1977.

Mr. KARTH. You are right. 1977—won't that help subdue inflation?

Secretary WEINBERGER. I don't think so, when you look at the degree of stimulation in there and the fact that some of the economic predictions have come out in the precise months that were given in the previous year. I think 1975 and 1976 should be a time when we don't do anything to depress the economy.

Mr. KARTH. You said that we don't want to move upward in 1976. I say this might assist you in that regard if you had a tax increase going into effect in 1976.

Secretary WEINBERGER. I think that there will be no need for any depressant measures whatever in 1976. However, I think that by 1977 we will want to be very sure we don't get back into another inflationary cycle.

I think, if we put in any kind of tax increase——

Mr. KARTH. Mr. Secretary, you are not confident of economic recovery in 1976 are you?

Secretary WEINBERGER. I have no crystal ball. We do have the basic idea that with the measures that have been taken and that are about to be taken that we would have the steadily improving situation in 1976. We don't think this should be tampered with or injured by a tax.

Mr. KARTH. What if Congress doesn't take your advice as they didn't take your advice last year and the 5 percent doesn't go into effect, but the law follows what we are proposing? Then what happens?

Secretary WEINBERGER. All our figures are based on this assumption, and in that case the deficit in the present law would be \$3 billion in 1975 and about \$5.8 billion in 1976 and \$5.8 billion in 1977.

We think that we should not allow it to continue at that rate, even though we will still have reserves. We call attention, again, to the fact that would be corrected in a way that would not depress the economy by a modest limitation on the benefit increase when there is still time.

Mr. JONES. Would you yield?

Mr. KARTH. I yield.

Mr. JONES. You talk about this not having a depressing effect on the economy. When you take this out of the economy, it is bound to have a depressing effect.

Secretary WEINBERGER. The \$2 billion is the amount that is added to the deficit by the refusal of the Congress to enact the five percent limitation.

Mr. KARTH. He is talking about holding it at 5 percent as opposed to going to 8 percent. That has a depressing effect.

Secretary WEINBERGER. No, that means there is \$2 billion less stimulation.

Mr. BURKE. Under the 5-minute rule, I think, we will have to recognize the members.

Mr. ARCHER. May we go in and vote?

Mr. BURKE. We will go in and vote, and Mr. Archer will be recognized first.

[A recess was taken.]

Mr. BURKE. Mr. Archer is recognized.

Mr. ARCHER. Mr. Secretary, I want to compliment you on a very prudent statement. I do wish that it had a little bit more flesh on the bones today with respect to some of the decoupling recommendations that you say you are working on. I think that is important for us to have that recommendation.

I do want to ask you about some fourth and fifth and sixth alternatives. You say there are only three. I think there may be others.

I would like to say, quickly, to you that I believe there has been a little political gamesmanship going on with you earlier this morning. I don't for 1 minute, believe that this Congress is going to abandon its operating procedure of increasing benefits in an election year and waiting to put the taxes on in the year after the election year. You would tend to think, from some of the comments made earlier this morning that, this is what the Congress procedure is and that it is only the administration that wants them to abandon that.

Secretary WEINBERGER. I was puzzled.

Mr. ARCHER. We know that if you had recommended a tax in 1976 you would have borne the brunt of it in a political year, but they would never have enacted it until 1977 anyhow.

I think we have to dismiss some of this give and take as a little political gamesmanship that has occurred earlier this morning. Since Commissioner Cardwell is here with you today, perhaps my first question should be directed to him. I am curious about why the advice that we got from the actuaries in 1973, 2 years after the census of 1970, did not show the demographic changes that you mentioned in your statement.

We were told by the actuaries then that there would be only a minus 0.5 percent deficit. That was too much as it was—don't misunderstand when I say "only."

Nevertheless, the actuaries told us that there would be a minus 0.5 percent deficit in the payroll in 1973 and now they come back and there are these tremendous demographic changes as a result of the 1970 census. Why didn't they have that in 1973?

Secretary WEINBERGER. I can only guess what was inside the actuarial minds. Let me give you a short try.

There were other factors besides the demographic factors that were involved, but demographic was very big in the long range. I think there was not any feeling of certainty regarding the demographic trends. I use "certainty" as a completely relative term.

We are talking about a 75-year prediction. I think they didn't have any feeling that they were in a position to say that the population trend, which was then becoming apparent, would be in any sense a permanent or fixed trend. Rather than assume that, they went back and used more general averages.

I think, now, it does seem that that trend may well continue out into the future. The zero population growth people have done their

work well, and there is a general feeling, and certainly I encountered it when I headed our delegation to the Population Conference in Bucharest, that the population in the United States is very likely going to remain on a path that will run down this particular avenue.

The actuaries can certainly speak for themselves, but that is my impression; they weren't quite sure enough, at that time, or didn't feel any degree of certainty to be able to say that that demographic trend was going to continue. It is a major trend. It does not manifest itself until somewhere in the area of 2010 or 2013, because it is about at that point that the number of members of the work force relative to the number of the retired group changes so very dramatically.

But there are a lot of other factors. The benefits were increased substantially—

Mr. ARCHER. I understand that. I was making my question specifically at that one point, and I would say that, in response to your comment, that if that is the situation, then why did you not say that these demographic changes and the revised projections have occurred as a result of data accumulated subsequent to the 1970 census rather than data based on the 1970 census, because that was all available in 1973?

Secretary WEINBERGER. It was. It is how you interpret that.

Mr. CARDWELL. I would like to talk for the record, first of all, about the considerations you referred to in the fall of 1973.

Your question is why, as of the fall of 1973, did we not have long-range demographic projections based on the 1970 census.

I asked that question in May 1974, when the trustees report for that year made the disclosure that we are now talking about. The disclosure was made a year ago.

The answer is that demographers, themselves, had not reached their conclusion resulting from the 1970 data as of the fall of 1973. They had, however, by the spring of 1974, and at that time these conclusions were introduced and the deficit that was forecast a year ago, and published in the trustees report in May 1974, raised this very issue.

Mr. ARCHER. You mentioned that there has been a 70-percent increase in benefits in the last 5 years. Do you have the corresponding increase in the CPI?

Secretary WEINBERGER. It is roughly about 40 percent. So that it isn't quite double, but it is almost double the cost-of-living index during that period.

Mr. ARCHER. Do you have information readily available for the 5 years preceding the immediate last 5 years?

Secretary WEINBERGER. I don't have it with me this morning, but we can certainly get it for you.

Mr. ARCHER. Comparing the benefit increases to the CPI increase?

Secretary WEINBERGER. I would venture to guess, Congressman Archer, that it was nothing like that, that during that 5-year period the benefit increases were quite unprecedented. Commissioner Cardwell can get the exact figures.

[The information follows:]

RECENT INCREASES IN THE CPI AND IN SOCIAL SECURITY BENEFITS

Over the last 15 years (from January 1970 through January 1975), social security benefits have been increased across-the-board by 68.5 percent. This compares to

a 37.8 percent increase in the cost of living as measured by the Consumer Price Index. Benefits were increased by 15 percent beginning January 1970, 10 percent beginning January 1971, 20 percent beginning September 1972 and 11 percent beginning June 1974. The CPI increased from 113.3 in January 1970 to 156.1 in January 1975.

Over the preceding 5 years (from January 1966 to January 1970), both social security benefits and the cost of living (as measured by the Consumer Price Index) increased by 20.9 percent. Benefits were increased by 7 percent beginning January 1965 and by 13 percent beginning February 1968. The CPI increased from 93.7 in January 1965 to 113.3 in January 1970.

Mr. ARCHER. Do you have any rough approximation of what it would have been for the preceding 5 years?

Mr. CARDWELL. No, sir, I don't have that with me today.

Mr. ARCHER. What would be your viewpoint with respect to the recommendation that Professor Feldstein made to us that we ought to create a capital fund in the social security system so that we can level out in effect the percentage of payroll that is going to have to be put into the fund between this generation and the next generation and the generation thereafter?

We are talking now about putting in 11 to 12 percent and maybe 13 percent if we go to an increase in the payroll tax, whereas down the line, as I understand it, future generations are going to be faced with perhaps 22 or 23 percent of payroll in order to meet the requirements of the fund.

He has recommended that we be fair with future generations and pay an equal percentage of our total payroll today that we are in effect passing on to them in the future and level it out in effect over the next 75 years.

What would be your position on that?

Secretary WEINBERGER. My position on that is that it probably has some theoretical advantages to consider but that practically speaking we simply cannot tie up that amount of capital these days when we have a deficit of \$60 billion to \$70 billion, and in my view shall subsequently need more private capital invested in job-producing enterprises. I can't see any way in which we could justify taking that much capital out of the availability for job-producing activities.

I do concur in your concern about a high payroll tax, and there are two points I think we should make. One is that it is essential to enact decoupling and, commenting on your statement a moment ago, there will be no reason for Congress to fear that we will delay them at all in the consideration of that.

We will have a very specific proposal on that, and the President has endorsed the whole idea. It is a complex matter, but it really has to be done. That will solve a good part of the problem.

I do think we have to avoid these very large benefit increases, far above the cost of living, which you spoke of because this will throw the whole system out of kilter.

A lot of people have not considered one thing, which is the effect of the very high payroll tax—12 percent is very high in my opinion. If you go up into the 18 and 20 percent, as you could very easily do, if all you are interested in is just benefit increases on a regular basis way beyond the cost of living and using Social Security for a kind of public welfare program, then you put a strong deterrent on employment. An employer will have every inducement to try to avoid any kind of labor-intensive activity if the payroll tax is around 20 percent. That

will affect most adversely and most quickly the people for whom it is hardest to secure employment, people of low income and basically unskilled in unskilled jobs.

So that on every count that is one of the reasons I fought so hard and continue to fight so hard against any kind of health insurance scheme based on a step increase in social security payroll taxes.

Mr. ARCHER. Mr. Secretary, Professor Feldstein's projections show that this capital fund would increase the available amount of capital in this country rather than reduce it. You have said that you were concerned about it because it would reduce the available capital. His projections show that it would increase the available capital in the private sector.

I suggest that your people analyze that carefully. I would like to get a report from you on it because you are at odds with his projection.

Secretary WEINBERGER. We certainly will look at it that way. I am not sufficiently familiar with the details of his proposal to be helpful to the committee this morning on it, but I do worry about the additions to the public sector that are required by the very heavy public financing and public expenditure requirements.

We are now well over 36 percent or 37 percent of the whole GNP going to Government, and that worries me because I think it is those trend increases which diminish the amount of capital that is available for job-producing investment in the private sector.

[The analysis and report follow:]

THE SECRETARY OF HEALTH, EDUCATION, AND WELFARE,
Washington, D.C., July 17, 1975.

Memorandum for the record.

Subject: Possible impact for Reserve financing of the Social Security System.

In my opinion, it is extremely difficult, if not impossible, for one to come to a definitive conclusion as to whether or not reserve financing of social security would lead to greater capital development than can be accumulated under the present pay-as-you-go method of finance. My first concern with the proposition stems from the fact that in order to move from pay-as-you-go to partial- or full-reserve financing, sizable increases in the social security contributions paid by employees, employers, and the self-employed would be necessary. The imposition of such increases in, say, 1976 would reduce personal disposable income and thereby, further depress an already weak economy. At the very least, a large increase in social security taxes in 1976 would tend to offset the economic advantages gained by the reductions in Federal income taxes that were enacted earlier this year.

In the context of the intermediate and longer term effects of partial- or full-reserve financing of the social security system, assuming full employment is maintained, reserve financing of the social security system could lead to a larger accumulation of capital than under the current pay-as-you-go system. However, a larger capital stock would not be assured under reserve financing of social security. The trust fund balances might be borrowed by the government to finance new and expanded governmental programs instead of being used to reduce the amount of government debt held by the private sector, as envisaged by Professor Feldstein. If reserve financing led to increased non-social security expenditures, and I believe this is clearly within the realm of possibility, it is unlikely that the capital stock would be larger under reserve financing than under pay-as-you-go financing. In addition, the annual increases in social security revenues might well be used to finance increased social security benefits, and the trust funds might, in practice, never be allowed to accumulate substantial reserves.

Enclosed, for inclusion at this point in the record, is a general statement prepared by the Social Security Administration concerning work they are doing with regard to questions Professor Feldstein has raised and general questions concerning some of his conclusions.

CASPAR W. WEINBERGER,
Secretary.

Enclosure.

STATEMENT BY SOCIAL SECURITY ADMINISTRATION CONCERNING PROPOSAL BY
PROFESSOR MARTIN FELDSTEIN FOR FULL OR SUBSTANTIAL FUNDING OF THE
SOCIAL SECURITY PROGRAM

Martin Feldstein has published several studies which explore the relationship between social security and capital formation. The main thrust of these studies is that social security has reduced personal savings substantially and thus has inhibited capital formation. We are currently engaged in testing within the empirical framework used by Feldstein to study the impact of social security on personal savings. This work is an attempt to validate his findings with regard to the magnitude of the reduction in savings that he attributes to the introduction of social security.

In addition to this work within the Feldstein framework, we expect to explore the interrelated effects of savings decisions and work effort as affected by social security at the macro-economic level. We also plan to validate and extend Feldstein's research based on aggregate cross-country data.

We should make it clear that because social security coverage is almost universal, it is not possible to test directly the influence of social security at the individual level (i.e., no reasonably similar control group can be established). Nonetheless, we believe that a better understanding of the individual's saving behavior would provide clues to the influence of social security on saving. However, with present resource limitations, the cost of developing the necessary data base precludes any immediate plans for a study of this issue.

As regards Feldstein's analysis per se, the following points should be raised concerning their implications for future social security policy. Most of these points will be covered in more detail in a forthcoming article in the *Social Security Bulletin* (July issue).

1. The statistical evidence presented by Feldstein suggests that social security reduces savings. However, we have serious questions as to whether the size of the reduction is as large as his results indicate. We are pursuing several technical questions related to his statistical work at the present time. Until this work is completed, we would caution that Feldstein may overstate the impact of social security on savings.

2. Feldstein's basic argument hinges on the notion that workers are able to perceive and also incorporate their expected retirement benefits into their current consumption behavior. We know of no evidence which indicates the degree to which this actually happens.

3. However, even if saving has been significantly reduced, this is not necessarily inconsistent with the goals on our society. For instance, we as a society may well prefer more current consumption (in the form of support for the aged population) to more capital formation.

4. If social security were to go to a reserve fund form of financing, the problems associated with that decision should be made clear. For this kind of system to work, as Feldstein describes it, requires (a) government policies which consistently maintain full employment; (b) a willingness to accept Federal Government ownership of State and local securities and certain kinds of private securities; and (c) a willingness by the current generation of workers to accept substantial short-term increases in the payroll tax rate in order to lower taxes for future generations of workers. Given that there are alternative policies to reserve funding which will stimulate capital formation, the need to use the social security system to serve that function is not at all clear.

5. We are quite skeptical that in the absence of social security, households would have voluntarily accumulated additional wealth in the amount of \$2 trillion as Feldstein asserts. If, on the other hand, he means that the system should have been funded historically, we should note that substantially higher contribution rates would have been required and that financing of "past service credits" of older participants would have required additional taxes—payroll or general revenue.

6. It is not possible to determine whether it would be more fair to increase payroll taxes of the current generation so that future generations would have lower tax rates. How does one compare the welfare of generations separated by a half-century? In all likelihood, future generations will be richer than we are and therefore have more ability to pay higher tax rates. The demographic pattern that results in a higher ratio of old persons to workers also implies a lower ratio of children to workers. The fiscal effort to support the young should therefore be lower.

The fairness argument can be applied with equal vigor to the comparison of the present generation with earlier generation social security participants. Workers today are paying substantially higher taxes for longer periods than did earlier generations. As noted, we may view the contributions of current workers as financing "past service credits" of older workers. It would hardly seem fair to current workers whose contributions are being used to finance current benefits to have the tax rate raised to reduce the burden of later generations.

Mr. ARCHER. I assume that you are opposed to paying for medicare out of general revenue, which is one of the recommendations of the Advisory Council?

Secretary WEINBERGER. Yes, sir.

Mr. ARCHER. What about a fourth and fifth alternative of excising from the social security program those payments which, in effect, are welfare, which are not earned as a matter of right relative to the premium paid in?

Secretary WEINBERGER. What are those specifically?

Mr. ARCHER. The minimum benefit schedule, for example, is one. Another is, I am told, the survivor's benefits, the disability benefits, to rework all of those so that they will relate to the premium paid in as a matter of earned right and then take the other part and through an SSI-type program let this come out of general revenue.

That would reduce the tremendous amount of load on the fund. What would be your reaction to that?

Secretary WEINBERGER. My immediate reaction, if you are talking about it this year, is that we don't have any general fund left. There are no general revenues available for any purpose except to add to the deficit.

If you are talking in the long range, I have a much better plan. That would be basically to eliminate a great many of the existing categorical public assistance welfare programs, not create any more, not shift the funding, but eliminate and substitute a straight cash grant based on need.

Mr. ARCHER. That is a separate program. I am talking about revising the social security benefits so that they will be related as a matter of right to the premium paid in.

Secretary WEINBERGER. I would not want to do it just by itself. I would only want to consider it in a context of a total revision of the public assistance program, which I think sorely needs revision.

Mr. BURKE. We will go out and vote and come right back.

[A recess was taken.]

Mr. BURKE. Mr. Archer is still recognized.

Mr. ARCHER. Mr. Secretary, as another alternative to help to spread out the changes in the program and the impact of the costs of those changes, what would be your position with respect to voluntarily exempting some of the self-employment groups inasmuch as all of the self-employment groups today are a greater drain on the fund relative to the amount of premiums that they pay in?

Secretary WEINBERGER. Well, you have a serious problem of equity there, I think, Congressman Archer, because you should not really penalize people because they are in self-employment. As a matter of fact, we used to encourage that a few years ago and I think it is a good thing to encourage. It may be that the rates need some adjustment because as you know the rate is an attempted combination of the two but I won't make any kind of recommendation of that sort now.

I think if you took out people in self-employment from the benefits of the system I would have a very difficult equity problem with that.

Mr. ARCHER. Even if they voluntarily elected not to participate? You would not be taking anything away from them if they did voluntarily decide to exempt themselves.

Secretary WEINBERGER. You would have some problems with the total base that is available for the whole system. I think that the Advisory Council has recommended, as I recall it, an increase in the rate for self-employed people to try to make up for some of the problem to which you have correctly referred. The voluntary opting out of the system, I think, has some real problems because of its effect on the total base structure that is available for everybody in it.

Mr. ARCHER. But relatively the total base would be improved because the Advisory Council has not recommended that the tax rate be on par with that of the employer-employee.

Secretary WEINBERGER. No; it shouldn't be double.

Mr. ARCHER. If it is not on par it is not producing the same amount of funds relative to benefits paid out that the employer-employee sector is.

Secretary WEINBERGER. I think the original design of the program was based on the idea that it was very desirable to encourage self-employment and that it was so desirable that it wasn't considered proper to put what would amount to a penalty on it of a double tax simply because you were self-employed. I do think that consideration has to be given to the Advisory Council's recommendation that the rate be adjusted to balance the tax and benefit payments a little more evenly than is now the case.

Mr. ARCHER. Even that would not help the base, though. It would still erode the base. Even their recommendations would still erode the base as far as the availability of funds to pay benefits is concerned.

Secretary WEINBERGER. It would be one of the negative factors but there are a lot of positive factors and if some of the other recommendations we are talking about are put into effect your total base would be protected and saved.

Mr. ARCHER. But the testimony we have, Mr. Secretary, is that even if you raise the rates to the level that the Advisory Council recommended all of the self-employed groups will still be a greater drain on the system than the money that they are paying into the system so that if you can exempt any one of them you are going to benefit the soundness of the funding of the system.

Secretary WEINBERGER. You might not, Congressman Archer, if you put in an optional opting out for the self-employed. Many might not accept it and the Congress might then say that we shouldn't penalize those who remain in and therefore we will let the base erode further to take care of those who remain in. I have a feeling that what we have is a pretty good basic structure, but I do think the Advisory Council's recommendation for reconsideration of the self-employed rate is justified and ought to be done.

Mr. ARCHER. Mr. Secretary, we are not on the same track somewhere here because you keep saying that if you let a group out that that helps the funding of the program and it doesn't.

Secretary WEINBERGER. The problem, Congressman, is that you won't let a whole group out. You would only let selected members of

that group out. In order to make up for the reduced base of that group, you might have to erode the total base even further. That is the point I am trying to make.

If you said no self-employed could join you would have the result you are talking about because they would then indeed all be out but, if you have a half and half situation, you have fewer in that group and therefore the base would need more making up.

Mr. CARDWELL. The trade-off is between the person who is employed and the employer shares in the tax. He is in effect subsidizing this difference that you are talking about. Naturally there is a trade-off.

Mr. ARCHER. But the fact remains that you are only getting one and a half times as much money into the fund for a twofold benefit and anybody that you would let voluntarily exempt himself from the fund would be reducing the total burden on the fund because all of it is actuarially geared to a full two participation rather than a one and a half.

It strikes me as being strange, Mr. Secretary, that an administration that I thought believed in voluntarism, that you would not say that if someone voluntarily elected to exempt himself that he would not injure the fund. Because actually what he was paying in was less relative to the benefits that he was paying out to other people in the country, why would you say we won't let him voluntarily exempt himself?

Secretary WEINBERGER. My impression is that the amount of subsidy that the non-self-employed wage earner would have to make up would be increased by that procedure. There is a problem of adverse selection. Only those self-employed people who could expect to receive a high benefit relative to their contributions would elect to stay in the program. We do believe in voluntarism but the system is in place and has been in place since 1935 and there isn't too much opportunity to get a voluntary aspect throughout the social security system at this point without very serious maladjustments working their way through.

Mr. ARCHER. Thank you. Thank you, Mr. Secretary.

Mr. BURKE. Mr. Pickle is recognized.

Mr. PICKLE. Thank you, Mr. Chairman.

Mr. Secretary, good morning. When the amendments were made in the social security law in 1972 with respect to cost of living increases, did the administration recommend that or were you opposed to those cost of living increases?

Secretary WEINBERGER. No; the cost of living amendment was recommended by the administration for something like 2 to 3 years before it went in and was recommended in lieu of the benefit increases that came along.

Mr. PICKLE. You recommended that we institute those cost of living increases?

Secretary WEINBERGER. In lieu of the increased benefits.

Mr. PICKLE. Now, you recommend putting a cap on it?

Secretary WEINBERGER. Yes, because the "in lieu of" feature was forgotten and we had the cost of living plus enormous benefit increases. As a matter of fact, the cost of living provision was postponed because legislated benefit increases superseded the automatic adjustment provisions. Had it not been for those increases we would have

and would have recommended staying with the full cost-of-living increase this year.

This year for fiscal purposes we recommended a 5-percent increase, not 8 percent.

Mr. PICKLE. You recommend no increase in taxes at this time?

Secretary WEINBERGER. Yes, sir.

Mr. PICKLE. I was so much concerned that your statement made a very pointed reference to the fact that the Congress had cavalier disregard about the 5-percent cap.

Secretary WEINBERGER. I had reference to the fact that the bill wasn't even introduced, Mr. Pickle. I would think that is a fair description of it. We not only didn't get hearings, we didn't have the bill introduced. That certainly bears out the chairman's statement that no serious consideration was given to it.

Mr. PICKLE. Nobody on either side of the aisle introduced the bill?

Secretary WEINBERGER. That is right.

Mr. PICKLE. You are not being partisan?

Secretary WEINBERGER. No, sir. I am uniform in my condemnation.

Mr. PICKLE. You are recommending no increase in taxes because the economy is in such shape that even though we are facing big deficits you don't want to take that money out?

Secretary WEINBERGER. That is right.

Mr. PICKLE. One could have the feeling that you are more interested in being protective of the economy than you are of the solvency of the trust fund.

Secretary WEINBERGER. No, sir. The problem is when should the measures necessary be taken and when should they take effect? We say they should take effect in 1977 because that will be plenty of time to deal with the diminishing set of reserves.

There is no statutory nor indeed economically agreed upon amount that the reserves have to maintain.

Mr. PICKLE. Mr. Secretary, people who have appeared before us, trustees, the Advisory Committee, have recommended either raising the taxes or a combination and to do it within the next year or two. You have come and told us that we need not do anything until 1977.

Secretary WEINBERGER. All I say is what you do, which I think you should do soon, should not be effective until 1977.

Mr. PICKLE. This is 1975 so that you are saying that whatever you do you postpone the effectiveness of it for 2 years?

Secretary WEINBERGER. Yes, sir.

Mr. PICKLE. It seems to me that with people in the program, those who are committed to protect it such as the trustees recommending quicker action, that you are coming here and trying to tell us that everything is fine. The biggest problem we have at this point perhaps is the public confidence in the program. You are telling us that we have no problem and we don't have to act effectively at least for 2 more years. I think that is going to give us the feeling that we are still living in one of these paradises and we are on the merry-go-round.

I don't understand how you would come here and attempt to maintain the public confidence and tell us we don't have to do anything about the fund.

Secretary WEINBERGER. Let me try to explain because I am one of the trustees of the fund and take those obligations extremely seriously, as I think all trustees do and should.

What I am saying is one of the things that destroys public confidence most is a lot of unwarranted nonscientific based statements or cartoons or articles or speeches or anything else that pictures the social security as the sick man of America lying on an operating table. All that kind of business does worry the people.

Mr. PICKLE. Are you saying that the people are insincere in making these statements?

Secretary WEINBERGER. I am saying they don't understand the facts. The facts are that what we are talking about is a diminishing reserve. We are not talking about anything that is going to run out until 1982. As a result, we have time enough to do this thing properly and also are fortunate in that we don't have to have what we do take effect in a year in which it might that will harm an already weakened economy. That is essentially all I am saying.

I think it is very essential to address the problem now. My statement does address the problem now. It tells you one of the things that we still recommend strongly that we wish somebody would introduce so that we could get some hearings on it. That is a limitation on the amount of the benefit increase. That would take care of most of this year's problems. We think that it would help greatly in the remaining part of the short-term situation.

Mr. PICKLE. What kind of reserve do we have and should we have?

Secretary WEINBERGER. We have a reserve now that is roughly at about, as I recall, 66 percent. It diminishes down in 1982 to zero. That means that until 1982 even with the predicted deficits that we have you will still have more than enough to pay the obligations of the system. That is why I say some of the statements are misleading.

Mr. PICKLE. Won't the disability fund run out in about 1979? You talk of 1982.

Mr. Commissioner, is that correct or incorrect?

Mr. CARDWELL. As to the disability fund taken by itself, as we have explained to the committee before we think you can deal with that within the context of the two funds (OASI and DI).

Mr. PICKLE. That is not all that rosy.

Secretary WEINBERGER. We are saying you should certainly not take no action, certainly not overstate the problem and give any credence or encouragement to the people who without proper knowledge of the situation are saying that the social security system is in dire peril. It is not. It is time to take action. It is important and very fortunate that the action we have to take will not in any way need to be effective in a year that will injure the economy. That is all we are saying.

You have an option which we have proposed that has been before the Congress or before the country since January which would have alleviated the problem this year completely and it is still not too late to deal with it.

Mr. PICKLE. You keep going back to the 5 percent. That is the only thing you recommend?

Secretary WEINBERGER. That is what we recommend.

Mr. PICKLE. You, the administration, and the Congress recommended this. You want to take it back. Did you ever give a chicken a piece of corn with a string on it?

Secretary WEINBERGER. If I give you a whole ear of corn, that is what the Congress did with the benefits.

Mr. PICKLE. You say with the cost of living you gave us a whole ear of corn?

Secretary WEINBERGER. We gave a 70-percent increase at the time when the cost of living was going up about 40. The cost-of-living adjustments which we contemplated in lieu of these very sharp increases never had a chance to take place.

Mr. PICKLE. One other question: If we adopted the recommendation for decoupling, would that have had any effect on the short-range deficit?

Secretary WEINBERGER. It would have more effect on the long-range. Long-range it would cut the projected——

Mr. PICKLE. Between now and 1980 it would not have much effect?

Secretary WEINBERGER. Not a tremendous amount. It would have some. It would be a very important thing to do because it would set the country straight on the desire of both the Congress and the administration to make the system solvent and keep it solvent.

Mr. PICKLE. I believe some witnesses testified that if we enacted the decoupling that would clear our whole difficulties. You are saying that is not so.

Secretary WEINBERGER. I am saying that it would have a salutary effect on public confidence. Second, it would solve half of the long-range problems by itself; and third, it is an equitable, fair thing to do and we think it should be done.

Mr. PICKLE. I want to conclude. You and I are not getting very far along in agreement. On the reserve you say it should be 60 percent?

Secretary WEINBERGER. No, sir. I didn't finish my answer to you. I said at the present time it is about 66 percent. There is no statutory figure on reserve. A lot of people say it ought to be 100 percent. My own feeling is that probably somewhere in the neighborhood of 35 percent is an adequate level to be sure that we do have a situation where you have a few years in which you could see that you are going to have to do something to increase the revenues or reduce the benefits or both and therefore you have time.

I would say the tax rate would probably have to be too high to build the reserves up to 100 percent. My worry, as I mentioned to Congressman Archer, is too high a payroll tax. I think that has a very deterring effect on employment.

Mr. PICKLE. Thank you, Mr. Chairman.

Mr. BURKE. As I understand it, the trustees project that the deficit for 1975, 1976, and 1977 will be \$14,542 million.

Secretary WEINBERGER. For which 3 years, Mr. Chairman?

Mr. BURKE. 1975, 1976, and 1977.

Secretary WEINBERGER. Our figures are \$14.6 billion.

Mr. BURKE. Do you think that this should get some attention this year?

Secretary WEINBERGER. Yes; I do think so. I think that attention should be directed toward corrective measures that would take effect in 1977 because with these figures you will still have a reserve of 42 percent. That, I think, is an ample reserve left. We don't deplete the reserve below 42 percent.

Mr. BURKE. What kind of taxes are you going to recommend for 1977 that is going to take care of a \$14 billion deficit?

Secretary WEINBERGER. There is a whole range of different kinds of options if the Congress decides it wants to go by the tax increase route. We have proposed a different route. If you want to take some of those options we did mention in the statement that if you do it entirely without touching the base, if you do it entirely by social security tax rates, it will require 6.5 percent, each and that would be a 13-percent payroll tax which, I think, is quite high.

Mr. BURKE. That is going to take care of the \$14 billion deficit?

Secretary WEINBERGER. It will pull your reserves back up again to a point a little above 40 percent. What I think should be understood, Mr. Chairman, is that we have a situation at the moment in which we have a reserve of 67 percent. So what we need, then, to do is to see how much of that is going to be drawn down and 5 percent of it is going to be drawn down in 1 year, and 3 percent in another, and 2 percent in another, and so on, and these are the deficits you are citing and that is a correct definition.

When you get through with these 2 years of deficit you will still have about 40 percent reserve. Under those circumstances we think that the system is not in peril but it is fully timed with measures effective at the time they won't hurt the economy.

Mr. BURKE. I think that they predict that the reserves will drop to about \$31 billion.

Secretary WEINBERGER. By 1980 they will be 31 percent.

Mr. BURKE. What is the cost to the trust fund in the earning of interest when we drop from \$67 billion to \$31 billion annually? What is the loss of interest revenue to the trust fund?

Secretary WEINBERGER. They are invested in Government bonds and I think they earn about 7-percent interest.

Mr. BURKE. At 7 percent, what would the loss be for 3 years, say, for \$36 billion?

Secretary WEINBERGER. You have to understand the term "loss." It is an intergovernmental transaction.

Mr. BURKE. It is a loss for the trust fund. The trust fund doesn't earn that interest. When you drop those reserves down to \$31 billion it is like having \$100 in the bank and taking out \$50 of the \$100. You earn less than half the amount in interest when you draw out half of your principal.

Secretary WEINBERGER. As you draw down reserves, obviously there is less for the other side of the Government to pay interest on. That certainly is true, but that is taken into account as the total projection of what will be left in the reserve and there will still be a 42-percent reserve by 1977.

Mr. BURKE. You know I am concerned about that President who comes into office in January of 1977.

Secretary WEINBERGER. We all are.

Mr. BURKE. It will be shocking for him to be facing a \$14 billion deficit.

Secretary WEINBERGER. He won't be facing that, Mr. Chairman.

Mr. BURKE. You are practically telling Congress not to enact any taxes. You are asking Congress to enact a tax that will take place after the elections.

Secretary WEINBERGER. We are asking Congress to do several things, as a matter of fact. One of them is, first of all, not to increase

the total governmental deficit beyond what it is, to cut back on some of the proposals for doing that; second, in the social security system, to enact some legislation that will take care of the excess outgo that is required now because of the increased benefits that have been voted. We are also saying please don't increase taxes in a year when that will hurt the economy, when the economy does not and could not really stand a tax increase. That is all we are saying.

We are saying you should address it now. We are saying that the action that you take should be effective in 1977 when you will not injure the economy by a tax increase.

Mr. KARTH. Mr. Chairman.

Mr. BURKE. Mr. Karth.

Mr. KARTH. Those are very, very broad suggestions. Mr. Secretary. Do you have a specific proposal?

Secretary WEINBERGER. Yes, we do.

Mr. KARTH. What is it?

Secretary WEINBERGER. We think that you should avoid the necessity for a tax worry or a deficit worry this year by a proposal which will limit the benefit increases to 5 percent.

Mr. KARTH. If we don't do something by 1977, what is your specific recommendation other than the fact that we shouldn't increase benefits more than 5 percent?

Secretary WEINBERGER. We made a recommendation, Congressman Karth, that was totally and completely disregarded by the Congress.

Mr. KARTH. You are acting like a spoiled child who didn't get his candy. You are saying, "Because we didn't get the request we are not going to make a proposal." You have a responsibility much greater than that. You are suggesting that we ought to have one branch of Government, that if we don't adopt exactly what you propose you don't have an alternate proposal. I am trying to understand what you are saying.

Secretary WEINBERGER. There is still ample time to enact the proposal that we introduced in January, if we could get somebody to introduce the bill and hold hearings.

Mr. KARTH. There are three branches. You propose and we dispose. What is your proposal?

Secretary WEINBERGER. We have made a proposal to you which we think is——

Mr. BURKE. Mr. Secretary?

Secretary WEINBERGER. Yes, sir.

Mr. BURKE. Can you come up with names on the other side of the aisle who are willing to sponsor this 5-percent cap?

Secretary WEINBERGER. We would need perhaps a month or two. We got it introduced in the Senate.

Mr. BURKE. The checks are already being recomputed. As I understand it, the checks are already being prepared to include the 8-percent increase.

Secretary WEINBERGER. That is not correct. These would be the July checks and there is plenty of time to stop them.

Mr. BURKE. They are in the computer, aren't they?

Secretary WEINBERGER. Yes. But we have several computers.

Mr. BURKE. The testimony I had from the administration is that it takes about 6 to 10 weeks to even adjust the computer.

Secretary WEINBERGER. They have been adjusted.

Mr. BURKE. They have been adjusted. How long will it take them?

Secretary WEINBERGER. We have the old adjustments. All we do is pull out the programing for the new one and put the old one back in.

Mr. BURKE. You had it already adjusted for 5 percent?

Secretary WEINBERGER. No, sir. When the Congress did not act we started making the necessary adjustments because we certainly did not want to be in the position come July 1 of saying that we had not been able to comply with the intent of Congress.

Mr. BURKE. You keep saying the intent. It was the law that said that the increase should be made.

Secretary WEINBERGER. We asked that the law be changed. When it became clear that the intent of the Congress was not to change the law thus far we got ready to carry out the intent by putting the checks in envelopes. There is still time to enact the 5-percent limitation on the increase.

Mr. BURKE. In other words, the administration chose to avoid the notice served by the 535 Members of Congress that there was no support for the 5 percent. I didn't hear one voice over here, believe me.

Secretary WEINBERGER. We are getting ourselves in position to carry out that voice. That will be done July 3 when the checks arrive unless—I was going to say cooler heads prevail, but I will say unless the 5 percent is enacted.

Mr. BURKE. I am shocked. In all the time I have been in the U.S. Congress I have never seen an administration take action like this where they made a proposal and, just because they didn't accept that specific proposal, they wouldn't come up with another proposal.

Secretary WEINBERGER. We are perfectly ready to cooperate with you in every way, Congressman, in working out these things.

Mr. BURKE. I am ready to cooperate with the administration but if they think I am going to do their work for them, that is different. I think you had better take a message back to them that we expect some responsibility on the part of the administration.

Secretary WEINBERGER. We were hoping for some basic approach from the other branches.

Mr. BURKE. I don't see how in facing a \$14 billion deficit in a trust fund for 1977 that with that we can honestly face the people and say, "We are not going to tax you this year and we are not going to tax you next year in the election year. You are going to get taxed after the election."

Mr. STEIGER. Will the Chairman yield?

Mr. BURKE. Yes.

Mr. STEIGER. I am perplexed at the posturing that goes on this morning. It is absolutely absurd. It won't be the first time.

Mr. BURKE. We have a \$14 billion deficit, Bill.

Mr. STEIGER. It is the first time I heard you express concern about that. It won't be the first time that Congress has done something after the election. I hope you will vote for the Ketchum amendment to speed up the impact of the gas tax prior to instead of after the election. Don't give me any of this rhetoric about what the administration is and is not doing.

If you will read his statement the Secretary was, I thought, quite clear. He wants a ceiling. Clearly, the ceiling isn't going to be adopted.

I won't introduce the bill. He can try for 3 months if he wants to on whether we are going to introduce a cap and it isn't going to happen.

He goes on to say, "While we do not have a specific tax proposal we would be receptive to congressional initiatives which conform to certain kinds of principles." He then outlines the principles.

Mr. BURKE. We have to face it this year.

Mr. STEIGER. You don't have to face it this year.

Mr. BURKE. Yes; I think we do.

Mr. STEIGER. You can adopt what the Secretary is talking about.

Mr. BURKE. I am expecting a little encouragement from this side of the table here and apparently they are shying away from it. I am a little bit shocked. You know, nobody likes to impose taxes.

Mr. STEIGER. Which side of the table are you looking to for encouragement?

Mr. BURKE. The administration side. All I am saying is that this is a wonderful proposal. I could carry this through the House so easily. We won't even have to have a rollcall. It will be adopted without objection. Everybody faces the 1976 election without having done anything to upset anybody and we have solved all the problems.

We haven't solved any problems. We are facing a \$14.6 billion deficit in 1977 and we have either got to bite the bullet or we are going to kid the people. If the administration wants to kid them I imagine there are a lot of fellows in Congress who will be happy to go along with them. They will get tremendous support for this proposal. I would have no difficulty carrying this bill through, but I am saying that it doesn't solve the problem of the \$14.6 billion deficit.

Mr. CRANE. Would you yield?

Mr. BURKE. Yes.

Mr. CRANE. I might consider introducing that 5-percent cap legislation.

Secretary WEINBERGER. We will get it to you this afternoon.

Mr. CRANE. The first question is, if we don't get the cap we can still anticipate that there is enough money in the fund to last?

Secretary WEINBERGER. Yes; and that is why I questioned the Chairman's use of the word "deficit." We would be drawing down the reserve, which is ample, by \$14 billion, which would certainly leave ample funds for several more years. We don't say that you should wait until after the election. We say that you should go ahead with this proposal since you won't take ours and that that should take effect not now but in 1977.

The people will know all about it. It will be published and enacted before everybody. We will be glad to help you with it but we believe that the proper way to go is the way we have proposed. I am delighted that you are going to introduce it.

Mr. CRANE. No, Mr. Secretary; I have not yet made that commitment. My point is that in principle the administration's recommendation for a 5-percent cap on wage increases as well as benefits makes sense in other categories where you are drawing upon general revenues, but here you are talking about a 5-percent cap in a fund that you indicate can carry us through 1982 without exhaustion and in addition to that you have recommended earlier a tax rebate with a view to providing a stimulus to the economy. Since the money in this fund will not be taken out of general revenues I don't see the logic behind recommending a cap in this particular category.

I can certainly see it in the other.

Secretary WEINBERGER. The cap in this particular category is to assure that there is not overstimulation because you can't isolate the trust fund from what goes on in the economy as a whole.

You also have to bear in mind that the tax cut we asked for was \$16½ billion and the Congress gave us \$27 billion plus two new unasked welfare programs, plus \$50 for every social security beneficiary.

Mr. CRANE. Let me ask you this question: Your recommendation of the 5-percent cap, it seems to me, in this particular program is to prevent overstimulation of the economy rather than primarily to meet the problem of exhaustion of the fund.

Secretary WEINBERGER. This would save \$2 billion in a deficit that is already threatening to exceed the amount voted by the budget committees of the Congress and far in excess of what the President proposed. If you could save \$2 billion out of that even by the standards we use in Washington that is a substantial amount.

Mr. CRANE. I shall reflect upon my consideration of putting the legislation in.

Thank you, Mr. Secretary.

Mr. BURKE. You are concerned about the loss of the \$2 billion but you don't mind losing over \$1 billion in interest as a result of your proposal to allow this drop in the reserve fund. This will cost us over \$1 billion in interest.

Secretary WEINBERGER. You are talking, Congressman, about additions or subtractions to a reserve fund for OASI that at the moment has about \$39 billion in it—about \$46 billion for OASDI combined. Since you do not want to have, I think, excessive reserves, and I think that is equally as bad as having too small a reserve, I think it is important to realize that you do have a situation here in which you do fortunately not have to have the effective date of the action that you take take place in a time when it will hurt the economy, but you certainly can take action and people will know all about it and it will help preserve that confidence which you and I agree the public has to have in this system.

Mr. BURKE. Mr. Jones.

Mr. JONES. Thank you, Mr. Chairman.

First of all, Mr. Secretary, Secretary Simon came up to the full committee earlier in the year and said that if we don't enact the 5 percent cap it will be a \$3 billion addition. You are saying \$2 billion; is that correct?

Secretary WEINBERGER. We may be rounding it differently.

Mr. CARDWELL. Secretary Simon was working against an earlier assumption of a higher cost of living increase in benefits.

Secretary WEINBERGER. We have been successful in reducing the rate of inflation so that it is not quite as much as it would otherwise have been.

Mr. JONES. How much does the recession contribute to this deficit?

Secretary WEINBERGER. The recession contributes to the deficit in the sense that it spawns all kinds of big spending programs that far exceed the kind of income we have.

Mr. JONES. I am talking about the trust fund. If we had full employment would we have a problem?

Mr. CARDWELL. With full employment with a 4 or 5 percent cost of living you would have no problem. It is a combination of a very

sharp rise in cost of living to 8 percent and a very sharp rise in unemployment, a combination of the two.

We could probably estimate for the record the relative value of those two factors. We can't do it now.

Mr. JONES. I would like to have that.

[The information follows:]

If the economy had been operating at full employment, contribution income to the OASDI trust funds would have totaled an estimated \$72.8 billion in calendar year 1975. The estimated amount of contribution income to the OASDI trust funds in calendar year 1975, as shown in Table 15 of the 1975 trustees report, is \$63.2 billion.

An automatic benefit increase of 8% is scheduled to become effective for June 1975 under present law. The amount of benefit payments in calendar year 1975 attributable to this 8% increase is estimated to total \$2.7 billion. If the benefit increase were assumed to be 5%, the amount of benefit payments in calendar year 1975 attributable to such increase is estimated to total \$1.7 billion.

Mr. JONES. This is not the first time the trust fund has had a drop in expenditures. I believe it dropped in 1958 and 1959.

Mr. CARDWELL. Yes.

Mr. JONES. What was the story behind that?

Secretary WEINBERGER. I imagine there were temporary factors such as unemployment that came in from time to time and for a short time dropped it below.

Bruce?

Mr. CARDWELL. There have been times in the past when, for more than 1 year, there were deficits. The annual deficits were relatively small. I think there was one instance where the deficit for 1 year was larger than \$1.5 billion.

Mr. JONES. Weren't they tied to recession?

Mr. CARDWELL. They were reflecting changes in the economy, yes.

Mr. JONES. By the administration recommending the 5-percent cap, are you backing off from your support of the cost-of-living increase?

Secretary WEINBERGER. No, the cost-of-living increase was proposed by the administration about 2½ years before it was enacted. It was also proposed at all times as a measure in lieu of the 20 percent, 15 percent, and other increases in benefits that came along with great regularity. We did finally get it enacted, but its effective date had to be postponed because benefit increases were enacted. We are saying that you should have a cost-of-living increase. You have increased your benefits so far beyond the cost of living that this year, with the current fiscal limitations, it is reasonable to ask for a 5 percent, rather than 8-percent increase.

Mr. JONES. Putting this back onto the economy doesn't make sense.

Secretary WEINBERGER. I think it makes sense in the context of all the other things the Congress has done. The story of the tax-cut bill is that we asked for a \$16½ billion tax cut. We were handed a \$27 billion tax cut and a couple of new welfare programs that totaled about \$4.2 billion. That is an example, I think, of the kind of excesses that come along in this stimulation game.

We think it is very, very important that we don't have a social security tax increase taking effect in a year when we do believe the economy will be substantially improving. There is no political problem; if an increase is enacted the dimensions of it will be perfectly well-known, but it should not take effect at a time when it will injure the economy.

Mr. JONES. I submit to you that this 8 percent is going to be absolutely needed by those who receive it and that if that 8 percent is not given and that \$2 billion is taken out, we are going to have to make up for it in some other program.

Secretary WEINBERGER. I just have to disagree on that because again, there is not a need factor involved in a great many of the social security programs. If you are worried about need, you should add them to the supplemental security income program and not try to make social security into a welfare program. That has been one of the problems right along.

The cost of living has not only been met, but far exceeded, almost doubled over the last few years in this system.

Mr. JONES. Let me ask you on another point. There was some criticism expressed about the Secretary of the Treasury loaning this money from the trust fund out at lower than market interest rates.

How much in 2-percent loans still exist?

Secretary WEINBERGER. I will have to ask Mr. Cardwell.

Mr. CARDWELL. The fund still holds notes that were issued in past periods when the interest rate was very low. I can't give you relative proportions. The current interest rate is about $7\frac{1}{4}$ percent.

Mr. JONES. From the standpoint of trying to improve the reliability of the fund, why doesn't the Administration recommend that those notes be bought and reissued at the higher interest rate?

Mr. CARDWELL. First of all, that would take a change in law.

Mr. JONES. Why isn't it recommended?

Mr. CARDWELL. Primarily because it would change the whole financing fabric of the system. We do not see this as the best way to reconstruct the system's deficit. It cannot be denied that if you raise the going rate and reissued those notes that you would increase income into the fund, but it is not something that we are considering.

Secretary WEINBERGER. It is not a very large part.

Mr. CARDWELL. Very small. We can put the full dimension in the record.

[The information follows:]

The total invested assets of the OASI and DI trust funds at the end of March 1975 amounted to about \$46.2 billion. Of this amount, only \$1.7 billion, or 3.7 percent, was invested in securities bearing an interest rate of less than 4 percent. About \$1.1 billion, or 2 percent, was invested in securities bearing an interest rate of less than 3 percent.

INVESTMENTS HELD BY THE OLD-AGE AND SURVIVORS INSURANCE AND THE DISABILITY INSURANCE TRUST FUNDS, BY TYPE, MAR. 31, 1975

	Federal old-age and survivors insurance trust fund	Federal disability insurance trust fund
U.S. Treasury special issues:		
Certificates of indebtedness:		
$8\frac{1}{8}$ percent due June 30, 1975	0	0
$7\frac{7}{8}$ percent due June 30, 1975	0	0
$7\frac{1}{2}$ percent due June 30, 1975		
$7\frac{1}{8}$ percent due June 30, 1975	\$1,465,741,000.00	0
$6\frac{7}{8}$ percent due June 30, 1975	4,481,015,000.00	\$756,475,000.00
Notes:		
$6\frac{1}{2}$ percent due June 30, 1976	3,844,864,000.00	1,106,787,000.00
$7\frac{1}{8}$ percent due June 30, 1977	5,033,296,000.00	1,394,466,000.00
$6\frac{1}{2}$ percent due June 30, 1978	3,468,850,000.00	1,284,249,000.00
$5\frac{3}{4}$ percent due June 30, 1979	3,102,896,000.00	1,058,617,000.00
$6\frac{3}{8}$ percent due June 30, 1980	4,547,285,000.00	943,266,000.00

INVESTMENTS HELD BY THE OLD-AGE AND SURVIVORS INSURANCE AND THE DISABILITY INSURANCE TRUST
FUNDS, BY TYPE, MAR. 31, 1975—Continued

	Federal old-age and survivors insurance trust fund	Federal disability insurance trust fund
U.S. Treasury special issues—Continued		
Bonds:		
4½ percent due June 30, 1979	1,069,517,000.00	0
4½ percent due June 30, 1980	1,080,011,000.00	0
7½ percent due June 30, 1981	677,910,000.00	121,663,000.00
7½ percent due June 30, 1982	677,910,000.00	121,663,000.00
7½ percent due June 30, 1983	677,910,000.00	121,663,000.00
7½ percent due June 30, 1984	677,910,000.00	121,663,000.00
7½ percent due June 30, 1985	677,910,000.00	121,663,000.00
7½ percent due June 30, 1986	677,910,000.00	121,663,000.00
7½ percent due June 30, 1987	677,910,000.00	121,663,000.00
7½ percent due June 30, 1988	677,909,000.00	121,663,000.00
7½ percent due June 30, 1989	677,909,000.00	121,663,000.00
Total special issues	34,194,663,000.00	7,638,327,000.00
Marketable securities:		
U.S. Treasury securities:		
See exhibit "A" attached (face value)	2,457,146,000.00	314,995,000.00
Agency securities and participation certificates, see exhibit "B" attached (face value)	555,000,000.00	0
U.S. Treasury bonds—nonmarketable:		
2¾ percent of Apr. 1, 1975/80 investment series "B"	1,664,902,000.00	
Less: Unamortized premium and discount—Net	-13,412,984.69	-1,885,985.86
Plus: Accrued interest purchased	0	0
Total investments (book value)	38,258,298,015.31	7,951,936,014.14
Undisbursed balances	(35,047,227.37)	35,512,329.52
Total assets	38,223,250,787.94	7,987,448,343.66

EXHIBIT A

U.S. Treasury Securities:		
Notes:		
6 percent of May 15, 1975	\$17,450,000.00	\$3,750,000.00
7 percent of Nov. 15, 1975	50,000,000.00	0
6½ percent of May 15, 1976	22,180,000.00	0
6½ percent of Feb. 15, 1976	5,000,000.00	0
7½ percent of Aug. 15, 1976	90,500,000.00	26,000,000.00
8 percent of Feb. 15, 1977	15,000,000.00	10,000,000.00
7½ percent of Aug. 15, 1977	0	14,000,000.00
6½ percent of Feb. 15, 1978	0	2,000,000.00
6 percent of Nov. 15, 1978	0	2,000,000.00
Bonds:		
4½ percent of May 15, 1975/85	78,023,000.00	20,795,000.00
3½ percent of June 15, 1978/83	60,200,000.00	0
4 percent of Feb. 15, 1980	153,100,000.00	30,250,000.00
3½ percent of Nov. 15, 1980	449,450,000.00	0
7 percent of Aug. 15, 1981	50,000,000.00	0
6½ percent of Aug. 15, 1984	31,500,000.00	15,000,000.00
3½ percent of May 15, 1985	25,700,000.00	0
4½ percent of Aug. 15, 1987/92	33,000,000.00	80,800,000.00
7½ percent of Aug. 15, 1988/93	99,934,000.00	26,500,000.00
4½ percent of May 15, 1989/94	91,300,000.00	68,400,000.00
8½ percent of May 15, 1994/99	6,352,000.00	0
3½ percent of Feb. 15, 1990	556,250,000.00	10,500,000.00
3 percent of Feb. 15, 1995	70,170,000.00	0
3½ percent of Nov. 15, 1998	552,037,000.00	5,000,000.00
Total U.S. Treasury marketable securities	2,457,146,000.00	314,995,000.00

EXHIBIT B

Participation certificates:		
5.20 percent FALT, GNMA Jan. 19, 1982	100,000,000.00	
5.10 percent FALT, GNMA Apr. 6, 1987	50,000,000.00	
6.40 percent FAFT, GNMA Dec. 11, 1987	75,000,000.00	
6.05 percent FAFT, GNMA Feb. 1, 1988	65,000,000.00	
6.45 percent FAFT, GNMA Apr. 8, 1988	35,000,000.00	
6.20 percent FAFT, GNMA Aug. 12, 1988	230,000,000.00	
Total participation certificates	555,000,000.00	

Mr. JONES. Since the 5 percent cap is not going to be enacted and you are suggesting some increase in taxes, when could we expect a little more definite recommendation as to what kind of increase?

Secretary WEINBERGER. As I said, Congressman, we do believe that the committee will have its own proposal. We will be glad to work with you in every way that we can to help you develop the technical data. If you want to do it entirely by taxes, it would require a 6.5-percent rate. You could also use some extension of the base, there are a number of different options. Quite a substantial increase in the base is required in that case. If you want a combination of the two methods, we have some models that we would be glad to share with you, as to how those two could be put together.

Mr. JONES. Are you saying that the administration will not come up with a definite tax proposal?

Secretary WEINBERGER. We don't have any proposal at this time. I don't know what the future course will be. We do call the attention of the committee to the fact that we have proposed a solution that would take care of a large part of the problem. We will be glad to work with you on the development of your proposal.

There is still some time to enact ours, and we still urge its enactment strongly.

Mr. JONES. One of the drawbacks of increasing the base, as I understand it, is that you will have a quick influx of capital, but on the paying end down the line, you are going to have a progressive increase in benefits and thus, the funds will be decreased again and the drawback of just increasing the tax as opposed to the base, is that it is going to be regressive?

Secretary WEINBERGER. It is the deterrent effect on employment that I think is the most serious thing that I don't think enough people have really addressed.

Mr. JONES. Has the administration given any thought to a progressive tax?

Secretary WEINBERGER. I think certainly the Advisory Committee and others have considered this. It is not recommended, because again, this is a contributory system. This is not part of the income tax system. It does not have the elements that are involved in that. There has been consideration over the years given to that, but the Advisory Committee, which studied the whole system for a number of months, did not make that recommendation.

Mr. JONES. You would not expect the administration to?

Secretary WEINBERGER. No, I would not. I think we have to bear in mind the other aspects of it, and of those is that it is very necessary to encourage some savings. We were talking about capital formation a little while ago, and the way the country has always pulled itself out of recession before, and I am confident will do so again, is to attract enough private investment into job producing activities, so that new jobs are created and the great strength of the economy reasserts itself. But it is essential that you do have some savings attracted and that we don't absorb it all in general fund deficits or things of that kind.

Mr. JONES. One of the witnesses last week, suggested or agreed that if we took medicare out of the fund and incorporated it into National

Health Insurance, and furnished it totally from general revenues, there would not be the need for a 1-percent tax increase.

Secretary WEINBERGER. You would have to worry about what you were going to do to sustain the general fund, because I think there is a minus \$67 billion or whatever it turns out to be.

Mr. JONES. It would depend to a great extent on recovery of the economy. What is your impression of taking medicare out of the trust fund?

Secretary WEINBERGER. I am very strongly opposed to any use of the general fund for the social security activities that are now financed by the trust fund. I mentioned in my statement that there are two or three reasons for that. The most immediate one is that there just simply isn't any general fund. The other is that you destroy the contributory aspects of social security.

The third is that you completely eliminate any trace of discipline of the system, which at the present time, at least, purports to require revenues to match outgo.

Mr. JONES. I have two other questions, Mr. Chairman.

First of all, as to the earned income limitation, does the administration have any interest in raising that limitation?

Secretary WEINBERGER. Yes, some, I think. That is one of the proposals that is under consideration. Again, the total effect or cost of it would have to be weighed against the particular times.

Mr. JONES. Would the income?

Secretary WEINBERGER. All of these things would have to be considered. That is certainly something to which consideration would be given. There are a couple of others.

Mr. JONES. Thank you, Mr. Chairman.

I want to thank the Secretary for his comments on page 3, which say that there are no general revenues available, which totally supports the position I have had in the field of general revenue sharing.

Secretary WEINBERGER. We have some other recommendations for reductions as to freeing up money for that purpose, if you care to hear them.

Mr. JONES. No.

Mr. BURKE. Mr. Steiger is recognized.

Mr. STEIGER. Thank you, Mr. Chairman.

I don't know that there are any questions left to be asked of the Secretary. I would only make the comment, Mr. Secretary, that it is not clear that you will find some member on the House side who is willing to take on the administration's cap proposal. I am not sure you will, but I wish you luck in your 2 or 3 months search for that individual. Given that, given my own judgment as to that, it does seem to me that this subcommittee is going to have to sit down with you and see if we can't work out some system to take care of the problem.

Secretary WEINBERGER. We would be very glad to join in that process.

Mr. STEIGER. If that is the case, let me go one step further. No. 1, I agree with you completely in that I don't think it makes any sense for us to propose cutting taxes on the one hand and then through a subterranean process in the social security system, raising taxes on the other, in 1975 and 1976. We can do that in 1977 and make sense out of it.

Second, if we sit down and talk about financing social security, are you going to be prepared to come up with some specific reactions to the Advisory Committee's report on other kinds of changes beyond the decoupling for our consideration?

Secretary WEINBERGER. Decoupling is the first and most important one. The Advisory Committee made some suggestions with respect to advancing the retirement age somewhere in the year 2020 or 2015, moving it to 68. That is a suggestion that would have a significant effect on the long-range problem, reducing the projected deficit from anywhere from one-half to 1 percent. Since we are talking about a 5-percent deficit, that would be significant. The decoupling would reduce it by 2½ percent so that the two proposals would have a significant effect together.

I am not saying that we advocate that, but that is something that does warrant consideration, particularly in view of the medical efforts that are being made by other elements of our department to not only increase life, but to make life in the later years much more enjoyable and more productive.

Frankly, I have always been opposed to any compulsory retirement age. I think that we may well want to look at that question in light of the demographic patterns that the actuaries tell us we will face—a vastly increased retired population and a constantly decreasing labor force, relative to the retired. These are the kinds of things that in the long range might be useful to consider, but it is important to note that the Advisory Committee suggested that this particular change come into effect somewhere well into the 21st century.

Mr. STEIGER. Are you going to be prepared to give us some reaction on a point that the gentleman from Oklahoma and I both raised a couple of times on retirement tests?

Secretary WEINBERGER. Yes, indeed, I am very interested in that.

Mr. STEIGER. Taxation of those over 65?

Secretary WEINBERGER. That bears very directly on this other problem that we have just mentioned. There ought to be some inducements if people are going to want to continue working. We would certainly want to consider that. I am not giving any personal or administration position on that, but we would be fully ready to discuss that because I think that is an important factor. I think one of the decisive facts that is always argued against that, is that the cost is quite a lot of money, the first year.

So, the year in which you do that ought to be a year planned for 2 or 3 years ahead of time and where you can do it without bad effects. I would be very interested in discussing that and working with the committee, as we go on in getting some good solutions.

I think the gentleman's proposal or suggestion is one that we certainly would be very interested in discussing, in all aspects.

Mr. STEIGER. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Mr. BURKE. Mr. Secretary, I think I can say that on this side of the aisle, it is going to be necessary for you to go back to the administration and ask them to reappraise their position. You place us in rather a unique position here of trying to carry the ball for you, and yet, you don't want to throw the ball.

Secretary WEINBERGER. We are certainly willing to work with you, Mr. Chairman. We have thrown it once, and many more incomplete passes don't have much appeal.

Mr. BURKE. I can see the advantages of a 1977 tax. I can see the advantages of an increase in 1977 tax, rather than having it in 1975 or 1976. I have been around a long time. I am in that age category that is thinking of that age—68 retirement. I am not 68 yet, but I will be there in a few years, if I survive.

I have admired you, Mr. Secretary, over the years, because you have shown a lot of courage down through the years. In fact, I am a little disappointed today. I don't think you went far enough.

Secretary WEINBERGER. Sorry, Mr. Chairman, I hate to disappoint you, but I hope to make it up by offering to work closely with you in the development of your programs.

Mr. BURKE. I wish you would go back to the administration and tell them we have to do some unpleasant things which might not be too popular. I think the main point to remember here is that we have to make sure that the trust fund is completely stable.

Secretary WEINBERGER. Right.

Mr. BURKE. That the people in years to come have a right to expect that their benefits will be paid.

Secretary WEINBERGER. I agree with you, absolutely.

Mr. BURKE. And that those who are working today are not paying taxes needlessly for a fund that won't be there when they reach retirement. We can't do that by postponing the inevitable.

As I pointed out, a \$14 billion deficit in 1977, this is something we have to deal with now.

Secretary WEINBERGER. The reserve can be depleted by that amount and still leave a substantial reserve. This gives us ample time so that the measures we take to repair that will not, by a premature effective date, injure the economy. But we will certainly discuss these things further.

Your advice is not any matter that we have lightly disregarded and I certainly wouldn't this time.

Mr. BURKE. What do you think would happen to the economy if the social security trust fund collapsed?

Secretary WEINBERGER. That is why we would never allow it to collapse. There isn't the remotest chance of that. That would never be allowed to happen by either your branch or ours.

Mr. BURKE. I wish you would be assured of that. I think that is what bothers most of us who are looking into this. I know that we have to do some unpopular and unpleasant things and we have to do them whether we like it or not; either that, or we are saying to the people out there that we are not concerned about the trust fund. I don't think we can afford to say that.

Secretary WEINBERGER. I was wondering—your endorsement of unpopular measures would lead me to suspect that you might introduce our 5 percent.

Mr. BURKE. I would introduce it in a minute if I were the initiator of this cost of living rise. I wouldn't mind it at all. But it was done on the other side of the aisle. You don't find any volunteers over here and I don't blame them. If you get one fellow on this side to file the bill you will more likely find he is not a candidate for reelection.

Secretary WEINBERGER. It is introduced in the Senate. Maybe you could pick it up when it comes over here.

Mr. BURKE. I am not going to ask who introduced it in the Senate. I assume he must be somebody who is not looking for a future in public office.

Mr. JONES. I agree with the trepidation but the \$50 rebate in the recent tax bill, what percentage of that 8-percent increase would that represent?

Secretary WEINBERGER. I could run it out.

Mr. JONES. Would it drop to 7 percent?

Secretary WEINBERGER. You will have to do it on an average because for those at the lower end of the benefit scale it is a much higher percentage. It must be all of 7 percent for some of the very minimum.

Mr. CARDWELL. It is less than a third of the 8 percent. It is about \$1.7 billion against \$8 billion.

Mr. BURKE. On behalf of the subcommittee, Mr. Secretary, we wish to thank you. We appreciate your appearance and also that of the Commissioner.

Secretary WEINBERGER. Thank you very much, Mr. Chairman.

Mr. BURKE. The committee stands adjourned to meet at 10 a.m. tomorrow in the Ways and Means hearing room in the Longworth Building.

[Whereupon, at 12:17 p.m. the subcommittee adjourned, to reconvene at 10 a.m. the following day, Wednesday, May 21, 1975.]

FINANCING THE SOCIAL SECURITY SYSTEM

WEDNESDAY, MAY 21, 1975

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The subcommittee met at 10:15 a.m., pursuant to notice in the main committee hearing room, Longworth House Office Building, Hon. James A. Burke (chairman of the subcommittee) presiding.

Mr. BURKE. The subcommittee will please come to order.

The subject matter for today's hearing relates to the problems that have arisen in relation to the administration of the social security program.

The Social Security Administration has come under fire in the past 2 years because of difficulties which never seemed to exist before. I think all would agree that the Social Security Administration has been under unusual strains during this period of time in implementing the supplemental security income program. While the SSI program comes under the jurisdiction of the Subcommittee on Public Assistance, we have to take cognizance of the effects it has had on the general operations of the Social Security Administration.

The part of the social security program which has incurred the most difficulty is the disability insurance program. The staff of the Ways and Means Committee reviewed the operation of the disability insurance program and issued an extensive report concerning it last year. Up until now, there has been very little apparent reaction from the Social Security Administration to the questions that were raised in that report.

I would expect, therefore, that today's hearing will concentrate very largely on the problems existing within the disability insurance program.

Today's hearing will conclude the initial stage of hearings before the subcommittee which have generally concentrated on the financing of the social security program. General public hearings will be conducted in the near future on this subject matter, and particularly on the early-year financing problems.

The agenda of the full Committee on Ways and Means and its subcommittees is rather full for the next several weeks. Therefore, the scheduling of our subcommittee's public hearings has not been decided at this time. We hope to hold these hearings as soon as possible, however, and an announcement concerning them will be made as soon as they are scheduled.

Our witnesses today will be Commissioner James B. Cardwell, who will be accompanied by Mr. James E. Marquis, Mr. Samuel Crouch, Mr. Robert L. Trachtenberg, and Mr. Stephen Kurzman.

STATEMENT OF JAMES B. CARDWELL, COMMISSIONER OF SOCIAL SECURITY, ACCOMPANIED BY JAMES E. MARQUIS, ASSISTANT COMMISSIONER FOR PROGRAM EVALUATION AND PLANNING; SAMUEL E. CROUCH, ACTING DIRECTOR, BUREAU OF DISABILITY INSURANCE; ROBERT L. TRACHTENBERG, DIRECTOR, BUREAU OF HEARINGS AND APPEALS, SOCIAL SECURITY ADMINISTRATION, AND MARY JANE FISKE, DEPUTY ASSISTANT SECRETARY FOR LEGISLATION (WELFARE), DEPARTMENT OF HEALTH, EDUCATION, AND WELFARE

Mr. CARDWELL. Thank you very much, Mr. Chairman.

I appreciate the opportunity to come back again. As difficult as I think this subject is going to be, in a way I am rather relieved not to have to talk a second time about financing, but we are open to any subject you want to take up.

I would note that Mr. Kurzman is not here, but that Miss Mary Jane Fiske is here in his stead and will assist us as we proceed.

As you have indicated, my statement today will deal with administration and management of the several programs administered by the Social Security Administration. I will also try to touch briefly on some matters which are now before the courts and/or the Congress and which may have impact on our future operations.

I will, of course, be happy to try to answer any questions you may have during or after our prepared statement is presented on these or other matters.

As we all know, public interest in social security and related programs has increased markedly over the last several years. Much of the increase in public interest is a natural result of the tremendous growth in the scope and variety of the programs administered by the Social Security Administration—programs that now touch, in one way or another, practically everyone in the country.

If I might depart from my prepared testimony, I would just note that 5 to 6 years ago we provided services directly to about 42 million people. Today our programs are involving about 60 million people in terms of the service side. That just shows you how things have changed and how quickly they have changed.

I will discuss briefly some of the major features of this growth. But first I must acknowledge that far too much of the publicity that the Social Security Administration has been receiving is not favorable. There have been many instances where public expectations have exceeded our capacity. Among these, I am sorry to say, have been too many instances where our performance has fallen short, not just of what the public has the right to expect, but of what we expect of ourselves. These are the instances that we want to cover in our review here today.

The most significant influence on the quality of SSA's service has, as the chairman indicated, been the supplemental security income pro-

gram, which went into effect in January 1974. The impact of the program has been significant in every quarter of SSA and has had an effect on practically every employee for over a year and a half.

In our original planning for the formative period of the SSI program, we assumed that the SSI claim would be simpler and easier to process. Because it was supposed to be simpler than the regular social security claims process, we and the Congress both assumed that it would be less costly in terms of money and manpower. Our experience has been just the opposite.

With the possible exception of medicare, this new program has been much more difficult to get underway than anything SSA has undertaken in the past. The concurrent passage of some major changes in the regular cash income programs, the retirement, survivors, and disability programs, all occurring at the same time, plus the coverage of disability beneficiaries under medicare, have also resulted in considerable strain upon SSA's ability to provide prompt and efficient service.

I am sure you can recall some of the problems SSA has when medicare was first put into effect. Several years passed before this program was completely shaken down and the process to obtain the kind of service people were accustomed to obtain from social security came back into play.

With the major amendments of 1972 and 1973, we are incurring similar shakedown problems. But even the initial impact of medicare had less effect on SSA's own staff and resources than SSI. In the case of medicare, much of the initial burden was carried by the private sector, the carriers. In the case of SSI, it's been all SSA—our offices and staff. Our offices and our staff have carried the full shock.

If we look at conditions program by program, perhaps the critical areas, including those pertaining to SSI, will be more apparent.

RETIREMENT AND SURVIVORS INSURANCE

First, let's look at retirement and survivors insurance, which is the basic SSA activity. In 1972, benefits were revised and expanded for a number of categories of beneficiaries, all of which added considerable work for the local offices and RSI program centers. These changes varied in size and scope but the cumulative effect had a major impact on our operations in this area. One of the most important of these changes was the change in the benefit rate for widows and widowers, which required rate changes affecting more than 4.3 million beneficiaries.

Other changes involved the enactment of a special minimum benefit based on the number of years of coverage under social security, a delayed retirement credit provision which provides for increased benefits for those delaying retirement until after age 65, an extension of benefits to dependent and survivor grandchildren under certain circumstances, as well as a number of other changes which had a more limited impact on SSA operations. These changes occurred in 1972.

The 1972 amendments also provided for a 20-percent increase in benefits. Then in February and again in May of 1974, benefit increases totaling 11 percent were processed as a result of legislation enacted

in 1973. Each of these increases required extensive preparation. In addition, they required all data processing systems to be changed to include the new calculations. Every time we make a change of this sort the client population tends to come into our offices and our contact stations with questions. These things take time and energy.

We can see the complexity involved in the benefit increases enacted in 1972 and 1973 when we look at an example of a claim filed in June 1974 with 1 full year retroactivity. The benefit rates applicable to such a claim would include three different rates, each of which would have to be used in order to arrive at the correct first check amount for the beneficiary. If the claim also included medicare, two premium amounts for part B would have had to be dealt with because the annual premium rate changes are effective in June of each year. Thus, the adjustments in benefit rates enacted in recent years have had a large-scale impact upon employee training—as we add complexity, we have to better prepare employees—on our own systems developments, and workload volume.

Along with regular cash benefits, as you know, we also administer provisions for special payments to persons aged 72 and over who do not qualify for the regular benefits. While these provisions are not difficult to administer and are not subject to all of the complications involved in the payment of regular benefits, there is a situation arising which may cause considerable problems with the special age-72 payments.

In a court case now pending appeal in the Federal Court, *Cintron v. Weinberger*, the provisions of law whereby the special age-72 payments are restricted to the 50 States and the District of Columbia have been challenged. If the plaintiffs are ultimately successful, as they have been in the district court, residents of Puerto Rico would also be eligible for this special payment. This would, of course, require a great deal of claims-taking in Puerto Rico and a great deal of preparation for that claims-taking. We are not now in a position to take that kind of caseload.

Administering the retirement and survivors insurance program, in terms of size and the number of people affected, is the largest activity of SSA. Most of the events which affect it also affect the other cash-benefit programs. We are not doing as well as we would like in providing speedy service, but we have made substantial improvements over the past several years even though there have been, as I have tried to point out so far, some temporary setbacks as various changes came into effect. In spite of the fact that total claims received during the first 4 months of 1975 were almost 7 percent higher than total claims received for the first 4 months of 1974, we were able to reduce the pending load in the local offices and program centers by about 4 percent over the same period. This, of course, reflects decreased processing time.

As we go through each of these programs I want to try to illustrate our conclusion as of this moment to the effect that we are gaining ground on all of our basic workloads with one exception, and that one exception will become very apparent when we get to it and it involves the hearings and appeals process.

This improvement in processing time, despite an increased workload, is a result of a number of things. For some years we have attempted to

shift the final action on new claims and benefit payment changes from the six SSA program centers to the local offices closer to the people in order to speed up the process. Also, we recently instituted a system whereby some of the less complex types of claims, in fact over half of the total claims filed, are certified for payments by our local district offices. This is expected to substantially reduce the average processing time. That is our objective.

In addition, during the past year and a half, the six RSI program centers have undergone extensive changes in procedures, with a view toward further improving processing time. Although the workload has increased, is now increasing, and will continue to increase, the number of pending cases in all categories of work at the program centers has dropped about 7 percent from the levels pending at the beginning of the changes that I have referred to—from 973,800 in December 1973 to 905,400 in April 1975. These changes have already made it easier to identify and process cases which for some reason or other are delayed and have become critical.

In summary, despite the growth in workloads, the administration of the RSI program is in relatively good shape and we have every reason to believe that it will steadily improve in the months ahead.

There is one problem which may seriously affect the administration of this program, however. I refer to the fact that there are a number of court cases dealing with due process of law now pending, and the number of such cases is growing. These cases and their outcome is what could substantially increase our work.

The most significant case is *Buffington-Biner v. Weinberger*, a class action which challenges the constitutionality of our procedures for recouping overpayments. In this case the lower court ordered that SSA cease recouping overpayments. In other words, not to recoup by reducing benefits until we offered all overpaid beneficiaries the opportunity for an oral preadjustment hearing. Our requests for a stay of this order were denied at both the circuit court and the Supreme Court level. To comply with the court order, we were forced to impose a moratorium against recouping overpayments by adjusting or reducing monthly benefits. We have appealed the substance of the lower court's decision to the U.S. Court of Appeals for the Ninth Circuit, but it may be several months before a decision is rendered by that court. Meanwhile, in an effort to lift the moratorium against the recoupment of overpayments, we have decided to offer an opportunity for a personal conference prior to any adjustment. We expect that we will begin to offer these personal conferences at three test sites, beginning in August. This will tell us whether or not we are right in our predictions of a bottleneck.

We may be able to conduct these conferences on a national basis early in 1976. Hopefully, the court will approve this proposal and permit us to lift the moratorium on the recoupment of overpayments by benefit adjustment or reduction by the latter part of this month. When the moratorium is lifted, if it is lifted, action must be taken on approximately one-half million overpayment cases.

Let me move now to the area cited by the chairman as being the most difficult, the disability insurance program. Although I would have a difficult time concluding that this area is more troublesome in terms of administration and management than the hearings and

appeals process—at least as of this point in time—I am quite convinced that the chairman is right, that year in and year out and over the long term, this is the most difficult and most troublesome assignment that has ever been given to SSA. I believe that the processing difficulties that we are experiencing in this area have root causes that are much more substantive than they are administrative or operational.

Permit me to summarize some of these root causes:

First, the definition is inherently difficult to adjudicate. It calls for a series of subjective judgments, concluded by an ultimate subjective judgment concerning a persons' basic capacity to work. Many private insurance disability programs, workmen's compensation laws, and other State, local and Federal Government pension systems define a person as being disabled if he or she can no longer engage in his or her regular and normal occupation. The social security definition is much stricter. It requires that the person be so disabled as to be unable to engage in substantial gainful work in any employment in the general labor market—not just employment suitable to his own skill or specialty. This is where the disability processing problem really starts. From the beginning, this has been a difficult and time-consuming task, and I believe it will always be a difficult and time-consuming task.

Next, the law specifies that the initial determination will be made by a second party—usually a State rehabilitation agency operating under contract with the Federal Government. This requires materials to move back and forth between the Federal level and the State level. But it does not stop there. Often, the process also requires the involvement of third parties and sometimes even fourth or fifth parties before the final determination can be made. Some sort of medical consultation is frequently required, involving either the claimant's own physician, a medical consultant designated by the State agency, or both. In other cases, the services of a fourth party, functioning as a technician, may be required. Usually the third and fourth parties are busy people in short supply. Thus, the requirement to transfer evidence back and forth between them is necessarily time-consuming. This is not their only work.

Finally, as if the process itself were not difficult enough, the problem is compounded at the moment because of a steadily growing workload. More claims are received each year. This impacted workload began with the introduction several years ago of the black lung program and was accompanied during the ensuing period by a steady rise in title II disability claims themselves. The problem has been compounded further, and this we must appreciate, by the introduction of the SSI disability program, the full impact of which is yet to be felt.

Up to this point in the current fiscal year, there have been over 1.5 million title II disability claims and more than 982,000 SSI claims made based on blindness or disability. That is a total of nearly 2½ million claims involving disability determinations. At the same time in fiscal year 1973, there had been only 1.2 million disability insurance claims received by the Agency. Part of the increase may be attributed to the growing unemployment rate—and we can always expect an increase in the number of disability applications when the unemployment rate increases. There is a direct relationship. Part of the increase is of course also attributable to the generally increased awareness and interest in social security.

One of the consequences of this increased activity in the disability programs is an increase in the number of denials. And when there is a large number of denials, it follows that there will be a large number of appeals. In order to speed up the process, we have made a number of changes in the basic claims processing system itself. For example, we have streamlined our procedures for handling critical cases, assigned additional responsibilities to the local offices, moved from a preadjudicative to a postadjudicative review of State agency determinations, and we think most important and with greatest promise is an experiment that we now have underway to test what happens if we require face-to-face redeterminations.

As a result of these procedural changes we have made in the initial determinations process, the total number of title II disability claims pending—and I am pleased to report this because a year ago I wouldn't have said that we could—dropped from 251,000 a year ago to 189,000 at the end of the last month.

BLACK LUNG BENEFIT PROGRAM

Let me speak further about the black lung program and the supplemental security disability program, which are the source of some of the main problems we still face in the disability area. When the Federal Coal Mine Health and Safety Act was enacted in 1969, the bill's sponsors estimated that about 54,400 miners would be eligible for black lung benefit payments. And it was assumed that that would be small potatoes in the Social Security Administration.

In the 5 years since the act was passed, SSA has received approximately 656,000 applications for black lung benefits. About 655,000 of these cases have been fully processed. After the 1972 amendments to the black lung law, over 200,000 claims which were initially denied had to be reworked. The law said go back and look at them a second time.

This had a tremendous impact on our overall operations, frankly, we have yet to fully recover from that impact. And even though the responsibility for making initial determinations on most new claims was transferred to the Department of Labor in July 1973, the Social Security Administration has, through its local offices, continued to take and develop claims for the Department of Labor.

Furthermore, despite the fact that all of the claims for black lung benefits for which SSA was responsible prior to July 1973 have been processed through to initial determinations, we still have the job of settling many of the appeals of those initial determinations.

SUPPLEMENTAL SECURITY INCOME FOR THE DISABLED

Since the beginning of the SSI program, SSA has taken a total of 2.8 million SSI applications over a period of about a year and a half. Of these, 1.65 million have been initial claims for payments based on disability or blindness; we have processed 1.44 million of these to payment or denial. But, here again, the denial rate has been high—50 percent. And, as I said earlier, a high denial rate leads to a high hearing rate. It naturally follows.

This takes us then to what has been so far the most stubborn of our workload problems, the hearings and appeals process.

HEARINGS AND APPEALS

As we have made steady progress in reducing the large disability backlog which built up over a number of years following the addition of the black lung benefits program and the supplemental security income program to SSA's responsibilities, the most critical problem area has shifted to the hearings and appeals level. There are now over 110,000 hearing cases awaiting action. This may not sound like a high figure when compared to the 2½-million SSI claims and the several million survivor claims, but when you think back and think of what a hearing process is like and visualize a small court you can see that a tremendous impact has resulted. One hundred and ten thousand is almost unthinkable in terms of sheer numbers in that context.

Of the 110,000 cases now awaiting action, about 51,000 are regular title II disability cases; 27,000 are black lung cases; 16,000 are SSI only cases; and nearly 13,000 are both SSI and regular DI cases. In other words, the person makes his claim under both programs or we determine that the claim has to be reviewed under both programs.

The most urgent business of the Social Security Administration at this time is to bring this hearings backlog down as quickly as possible. But with this kind of volume it is going to take considerable time to get the backlog down to a reasonable level. And I want to be sure that we do not here today appear in any way to overpromise, because this is not anything that we are going to be able to do very easily or very quickly.

We are, however, taking a variety of steps to reduce the backlog and to improve the overall hearings and appeals process. Nineteen newly-appointed administrative law judges and 27 newly-appointed SSI hearing examiners began hearing cases in April, and 50-60 additional ALJ's and approximately 20 additional HE's will begin training in June and July, respectively. We should have the benefit of their services by fall. The necessary clerical staff to support these presiding officers is also being hired.

Furthermore, we are attempting to extricate our presiding officers from all duties that they have been assigned that prove not to be relevant to the hearing and deciding of cases. For example, 259 additional temporary clerical and professional support positions have been authorized to assist the ALJ's and HE's to relieve them of everything but the very basic decision making part of the process. Of these authorized jobs 182 have been filled. In addition, we are in the process of recruiting and hiring up to 400 attorneys who will serve as law clerks to the presiding officers in an effort to relieve them of their nonhearing duties. They won't be ALJ's or hearing examiners because they will not have the full qualifications as such, but we hope that serving as law clerks and assistants to the presiding officers and hearing examiners they will be able to relieve them of even further activity.

Finally, we are exploring a variety of methods to resolve claims at an earlier stage in the adjudicatory process. Trained disability adjudicators have screened thousands of pending hearing cases to determine whether such cases can be remanded to State disability agencies for new decisions or additional medical development. This screening activity has already been done for large numbers of black lung hearing cases and we think it will pay off.

An experiment will be started next month requiring an informal remand on all new requests for hearing when the claimant alleges a change in condition or new evidence or other facts not considered in the previous decision. This should result, we believe, in a significant number of new hearing requests being resolved without the need for an oral hearing. Also, since January, SSA has been engaged in two major studies which we hope will significantly reduce the number of disability cases that presently go to hearing.

The first of these, the reconsideration interview study, RIS, now going on in 17 States, provides claimants with a face-to-face interview conducted by a skilled State agency disability adjudicator. The idea is that this adjudicator is able to observe in person the circumstances of the individual affected and may make a different decision and one that would not ultimately have to go to hearing.

The second, a due process study, would enable an individual to have a due process hearing with a State examiner before disability benefits are ceased because of medical improvement.

MEDICARE PROGRAM

Let me comment briefly on the medicare program. In fiscal year 1974, the Social Security Administration implemented, under Public Law 92-603, the first major expansion of the medicare program since the program was originally enacted. This extension of coverage—medicare for the disabled—provided medicare protection against the cost of health care for 1.8 million disabled persons in 1974. About 1.2 million of these people actually received services which were reimbursed under the program during 1974.

In the total medicare operation, it is estimated that bills under part A, the hospital insurance program, will have increased from just over 18.7 million in 1973 to about 25 million in fiscal year 1975—an increase of more than one-third over a 2-year period.

Under part B, the supplementary medical insurance program, it is estimated that claims will have increased from just over 58 million in 1973 to 79.4 million in fiscal year 1975—an increase of over 36 percent. Despite this increase in workload, the contractors, the carriers and intermediaries in their processing time for part B claims dropped from 19.4 days in 1973 to 17.1 days in the latest quarter for which we have compiled data, the one which ended in December 1974.

In part A, the processing time increased somewhat, advancing to 11.3 days in the quarter ending in December 1974, about 1 day more than in the comparable quarter in fiscal year 1973.

Public Law 92-603 also extended medicare protection to virtually all persons who have end-stage renal disease. Currently there are approximately 21,000 patients on the medicare rolls with this disease. Individuals with end-stage renal disease require either renal transplantation or dialysis to sustain life. Such forms of treatment are among the most expensive in medicine today, and everything in medicine seems to be expensive.

In implementing this new coverage, some modifications were necessary in the methods that are used to administer other portions of the medicare program. For example, since medicare covers nearly all medical care provided for this condition, under these new amendments, reimbursement on the basis of customary and prevailing

charges was no longer appropriate and new reimbursement methods had to be devised. These new methods have been generally accepted although there was resistance at first among the medical community, and the program, after a difficult start, is now operating quite well.

At present a little over \$6 million per week is being paid by medicare intermediaries and carriers to facilities, physicians, and suppliers providing medical services to kidney patients.

I would like, with your permission, to go back one last time to a general discussion of the supplemental security income program and the impact of that program on our overall performance. I would ask this even though I realized that the supplemental security income program is under the jurisdiction of another subcommittee.

I want to summarize briefly the SSI workload situation today since it has impacted so heavily on our other work. In 1973, the year before the SSI program became effective, we took approximately 5.6 million initial claims in the RSDHI programs. Additionally, SSA local offices took one-half million advance claims for benefits under the supplemental security income program. Even though the program had not yet been transferred to us we took claims in anticipation of the transfer. The law, of course, authorized that.

The year that SSI became effective, 1974, we took over 8 million initial claims for all of our activities. Of these, 2.3 million were claims for SSI benefits. Thus, while we were receiving these SSI claims, we were also receiving a slightly increased number of initial claims for RSDHI benefits as well. Despite the increased claims receipts during 1974 we have been able to reduce the number of claims pending in our local offices.

A year ago there were over 186,000 SSI claims pending in the field offices; the figure today is about 63,000—a reduction of about 66 percent. Also, a year ago at the end of April, there were approximately 241,000 RSI and 125,000 DI claims pending in the local offices. The figures today are 225,000 for RSI and 99,000 for DI—reductions of about 7 percent and 21 percent respectively. I reviewed this development earlier.

Since the local offices are, so to speak, at the front of the claims pipeline, I feel confident that these figures provide an indication of continuing improvement in the overall level of our service during the coming months, and, significant to me, some evidence that will sustain that improvement in the months ahead.

The levels of pending work are still higher than we would like them to be. We are not yet down to the level of 2 years ago, before SSI. However, we have reached the point where we are able to keep pace with the new claims workload, and at the same time bring down the number of cases pending. In every area we are now processing more work on a day-to-day basis than we are now receiving.

On the other hand, we still do not have all of our problems behind us insofar as SSI is concerned. We still have to develop automated post-entitlement systems for many SSI situations, and we still have a great deal of work to do on our billing procedures for determining State supplemental payment costs. As you probably know, we have to identify to those States for whom we administer supplements their fair share of the bill, in advance of each month's benefits. Much of this work is still being done in an improvised fashion, but we have both the know-how and concrete plans for its eventual automation.

Before leaving SSI, I would like to highlight some of the achievements that we see as having occurred already even during this formative period. This is important because everybody, ourselves included, tends to emphasize the problems and the negatives rather than the progress that has already occurred. For example, since January 1974, we have added a net of 1.4 million new beneficiaries to the number of aged, blind, and disabled transferred from the previous State assistance programs. There are now over 4 million beneficiaries receiving a total of over \$476 million monthly in Federal and State supplemental security income benefits.

For the record, during the first year, benefits to the aged poor were over \$2 billion higher than in the last year of the old program. I also note for the record that this \$2 billion was borne by the Treasury.

We see the above as true progress. The Congress now has under consideration a request for additional staffing to be assigned to the Social Security Administration for SSI and other purposes. It is our earnest belief that with these additional resources and with the computer facilities and hardware already on hand, we will indeed have the capacity to manage the SSI program effectively. There again, a year ago I am not certain that I would have made that statement.

Let me turn now to SSA's role in the Pension Reform Act. I don't think the Congress is aware that that program is about to impact on us, too. It is not only the Departments of Labor and the Treasury who are affected, even though they are the ones that the law points to.

The Employee Retirement Income Security Act of 1974 requires, among other things, that SSA record information received from the Department of the Treasury concerning deferred vested benefit rights of pension plan participants who terminate employment covered by a plan. Beginning January 1, 1978, the Social Security Administration will report this information to plan participants upon their request, or to the participant or his dependents or survivors automatically when they apply for social security benefits.

Although SSA's responsibilities under the new law require us to perform substantial systems modifications and to devote additional manpower to the task of maintaining and reporting the information in the vested benefit files, we do not anticipate any major problems in discharging these responsibilities. In other words, this is what the law says we are required to do.

We want to mention something else that is being requested of us. Private pension systems who through the years have not maintained their own records are now turning to us with requests to re-create for them the records of their beneficiaries using our files. This is a workload that we did not anticipate. I don't think the sponsors of the legislation anticipated it. Yet, if we fail to respond to these requests I doubt very much that the system can work effectively according to its scheduled dates, particularly the January 1, 1978, date.

Let me close by making a quick review of our staffing because staffing is at the heart of everything that we have been talking about so far, how well our people perform, whether there are enough people, whether they are in the right places.

SSA's staffing is determined through the budget process—we don't do it alone or by ourselves—and by congressional approval of specific employment levels. Over the past several years, the SSA employment

levels requested in the appropriations process and approved by the Congress have been as follows:

[The table follows:]

Fiscal year budget	Positions					
	President's budget request			Congressional action		
	Permanent ¹	Temporary and part time	Total	Permanent	Temporary and part time	Total
1972 -----	53,793	1,804	55,597	53,793	1,804	55,597
1973 -----	64,686	3,654	68,340	64,686	3,654	68,340
1974 -----	70,742	6,020	76,762	70,742	6,020	76,762
1975 -----	73,378	3,500	76,878	73,378	3,500	76,878
1975 with supplemental...	79,372	7,276	86,648	(2)	(2)	(2)
1976 -----	79,372	7,276	86,648	(2)	(2)	(2)

¹ Fiscal 1975 budget (with supplemental) and fiscal year 1976 budget includes term positions for employees who will be on board for more than 1 year but are not expected to become permanent additions to the Federal work force

² Pending in Congress.

Mr. CARDWELL. As I have already emphasized, many of the administrative problems we have experienced over the last several years are directly or indirectly attributable to the difficulties encountered in implementing the SSI program. In looking back it is clear that we underestimated the administrative impact of this program. We originally assumed that processing SSI claims would be simpler, and therefore less costly, than the processing of regular social security claims. However, the SSI program has been much more complex than anticipated, and it has taken more manpower than originally planned. As a result, it has been necessary for us to redeploy staff which compromised our performance across the board in all other programs as well.

One way to look at it is that 4 million beneficiaries that are represented by SSI account for about 15 percent of the total beneficiaries. A year ago we were probably applying somewhere close to 50 percent of our staffing resources to that 15 percent of our work. You see what happened. Something had to give.

Last year as the dimensions of the administrative problem and the inadequacy of then existing staffing authorizations became clear, we requested that the President authorize and request of the Congress additional employment and funding for administration of SSA programs. As a result, the President authorized a supplemental appropriation request for an additional 10,000 nonpermanent employees in order to reestablish SSA's full capacity to provide quality service. That was the basis on which he made his request. He asked us what would it take to meet our present workload and to work off our backlogs and this is what the request was intended to do.

The request has passed the House and the Senate committee has reported favorably upon it.

We were also authorized in the meantime to recruit this staff in anticipation of congressional action and that was done under authority that the President has under the deficiency apportionment statute. We are at this moment recruiting that staff and are well underway toward its application to our workload.

In conclusion, let me again express our agency's commitment to adequate service to the public and emphasize that we are making

every effort to bring about improvements in our operations. We will not be satisfied until we are again giving the public the high level of service that it has come to expect of us. I believe that the current prospects for steady progress in this direction are very good.

There is one point before I turn myself over to your questions that I would like to mention that is not in the prepared statement. It is a realization that must face us all fairly soon. That is, that agencies such as SSA are headed for trouble in terms of their capacity to maintain quality staff. I have just called for a review of the status and retirement plans of all of our senior officials who are eligible for retirement. The result shows that of our top 20 executives we are going to lose somewhere between 6 and 10 in the next 2 months. These agencies cannot live long and fulfill their responsibility if we allow that sort of change to continue to take place year-in and year-out. It will hurt and I would just remind us all of that.

Thank you.

Mr. BURKE. Thank you very much, Commissioner, for your fine statement. You have covered the ground very well.

In visiting your headquarters in Baltimore I could see firsthand the problems there which are tremendous. I have several questions I would like to ask.

The Education and Labor Committee is considering further changes in the black lung program. What is the extent of this legislation and what will its effects be?

Mr. CARDWELL. Well, the legislation could require us to go back a second time. I guess I could characterize it as a third time, and reconsider a number of the denied black lung cases. It would impact a third time on our disability claims processing system and would also protract the matter of adjudicating, in the appeals process the black lung cases.

One of the things we have been expecting is to work our way out of the black lung business and relieve ourselves of that part of our hearings workload. Under the existing law that prospect is in sight. We could probably do it within a year. If this new proposal were to become law in many cases we would have to start all over again. We have opposed the legislation and have so testified before the House.

Mr. BURKE. I think you said that you expected about 55,000 applications?

Mr. CARDWELL. The sponsors of the original black lung program estimated in their descriptions of the program to the Congress and to us that the law at the time of its original enactment would produce about 55,000 claims. The point we tried to make in our statement was that 55,000 has burgeoned to over 600,000 in the ensuing period. I think Mr. Crouch and others might be more familiar with the details of this new bill, than I. We can discuss the details if you like.

Mr. BURKE. Do you wish to add something to that?

Mr. CROUCH. Basically, the new bill would require that we reopen all the previous denials. There are about 200,000 of those. It would mean the rehandling and readjudication of approximately 200,000 claims and would also require that under certain circumstances new claims in the future could be filed and would be the responsibility of the Social Security Administration so that there would be some continuing workload for some years in the future.

Mr. BURKE. Thank you.

Commissioner, you mentioned the additional personnel that you have been authorized. Are you satisfied with this, or is there a problem that too many of these personnel are on a temporary basis? Do you think that is contributing to the morale problem?

Mr. CARDWELL. I think we have relied too much in the past on the use of temporary short-term employees, people who are hired off of the temporary civil service registers to work for 6 months or up to a year. There has been a tendency on the part of not just our agency but the Government generally, as we have tried to hold down the growth of Government and the enlargement of the Federal work force, to tell ourselves that these additional workloads were but temporary. It is quite clear that a lot of our temporary employees had to be converted to permanent employees and that we were really dealing with permanent workloads. This has frustrated our staff and the Civil Service Commission. It has also frustrated SSA and HEW management.

That is not the case, though, with respect to this 10,000 that is requested. The 10,000 requested are authorized as term appointments not to exceed 2 years. However, in an arrangement with the Civil Service Commission, we will be using their permanent registers for the selection of these people, and we believe that most of them will be convertible to permanent appointments as permanent vacancies occur.

You could ask why even 2-year permanent appointments. Primarily the reason is that we ourselves believe that these backlogs that we have talked about must be recognized as temporary. If we allow them to become galvanized as permanent parts of our work, we will have just crystallized a lower level of performance. We want to actually push ourselves to treat them as backlogs and to work them down. I feel confident that the agency will have an opportunity if it later turns out that permanent work force is required to get the permanent work force.

I think the problem that you point to, though, is largely this matter of the past where we relied very excessively on temporary, short-term appointments when in reality we were facing work that had some significant duration of several years or more.

Mr. BURKE. Considering the large number of new employees and new procedures, how well trained are these employees?

Mr. CARDWELL. Well, I will start by saying none of us is trained well enough. The Social Security Administration has had a great deal of experience in its basic workloads. I think we have learned in the past how to train the claims representative. It was quite clear that we did not have the opportunity to train our people on SSI sufficiently in advance of that transfer. We had neither the time nor the general opportunity.

I think we have a lot of training time to make up in that particular area. I think we will have a big training job ahead of us in the hearings and appeals process. In that case, we will have to do some retraining to recondition our hearing examiners and ALJ's. We will have to teach them new methods because we are quite convinced that with a limited number of such skills available to us, we are going to have to make greater use of them and improve their productivity. That is going to call for additional training.

In summary, the rapidity of our growth, the rapidity with which we have added staff, has put a serious demand on our training capacities, and I would have to say in all candor that I don't think we are up to par on training. It is something to which we will have to give a lot of attention.

Mr. BURKE. My time is up. Thank you, Mr. Commissioner.

Mr. Archer is recognized.

Mr. ARCHER. Mr. Cardwell, we appreciate your coming back before our committee and giving us the benefit of your experiences with the program. We know that you have been under a great deal of pressure in the last couple of years, and I hope that the Congress can do something to help alleviate that in the years ahead.

When you talk about the disability program, it shows a very substantial increase in the long-term deficit in the fund from 0.4 percent of payroll to 1.44 percent of payroll. That still seems to me to be based on rather optimistic assumptions. You assume, for instance, that the disability incidence rate will increase only 3 percent a year for the next 5 years, which I frankly believe is a little optimistic.

Don't your statistics show that the disability incidence rates have increased in the neighborhood of 6 percent a year in the last 5 years? How do you estimate that it will be only 3 percent in the face of this experience and the high unemployment rate? I can't tie these two figures together, and I would appreciate your comments on them.

Mr. CARDWELL. I think the actuaries themselves whom we did not bring with us today would tell us that this is one of the most difficult areas to project. The insurance industry has had exactly the same experience in the same line. They have always tended to understate the disability claims demands that would grow out of their own programs.

The record, I think, shows clearly that we have underestimated it, year in and year out. This year's trustees' report actually shows a more pessimistic, more conservative approach than in previous years. I think your question is, are we really right in our basic assumptions that underlie all of our long-term projections having to do with unemployment, employment, the size and shape of the population, and matters having to do with the cost of living, prices, wages, and productivity. These things were tied together in making the disability estimate.

I don't want to get at cross-purposes with our own actuaries, but I would have to take somewhat the same stand you take. If I look back at history it tells me that we have understated the cost of disability. As I said to you, I think the last time you and I talked about this subject, we were both affected by our conditioning that has taken place in the past. We all have wanted this program not to cost so much. I think that is what accounts for the very strict and difficult definition of disability. I think it is what accounts for the past underestimates of current costs. I think it is what accounts for our hesitancy to show higher and higher costs in the future.

I personally have some doubts as to whether that is good policy. I am not at all certain but what we are not again understating the possible costs. I wouldn't use the word "probably," but at least use word "possibly."

Mr. ARCHER. Does this increase of 6 percent represent a change in the administration of the program by loosening up the application of standards and qualifications?

Mr. CARDWELL. I don't think so. We have changed, starting back in the early 1970's, the way in which the original decisions are reviewed at the Federal level was modified. There used to be, as you know, 100-percent review at the Federal level. Review is now done on a sample basis. I think our own analysis of that experience is that that in itself doesn't make any difference. It might create the appearance that it is liberalizing the process but it really isn't, in our judgment.

It is true that we no longer have a case-by-case second look at the Federal level. We draw off a sample and examine that sample. The reversal rates when you get to the hearing process have not, as I understand them changed during the recent period.

One might draw his own conclusion that this is a liberalization, but I don't think it is. I think it is a change in technique, and a justified change.

Mr. ARCHER. If this percentage of increase is 6 percent rather than 3 percent for the next 5 years until 1980, what short-term effect will that have on the trust fund?

Mr. CARDWELL. It would have an effect on both short and long term.

Mr. ARCHER. That was my next question. What effect would it have on the long term?

Mr. CARDWELL. The theory is that the present rates are highly influenced by current and recent economic conditions. Those conditions will not prevail but the effect would be very significant. There is no question about it. I really would like to have the actuaries speak to this, if that could be arranged, either by talking about this later in another hearing or putting some information in the record on this point. I personally do not feel that I am prepared to talk to it.

Mr. ARCHER. We would appreciate it if that could be submitted for the record.

[The information follows:]

Previous disability insurance cost estimates have been based on future disability incidence rates that remain at the same level, i.e., no allowance has been made for future increases. For this year's report it was felt that an assumption of some increase in future incidence rates could be justified. A constant percentage increase each year in the future was ruled out, because this would imply unrealistic disability levels sometime in the future. For example, at the higher ages close to 100% of the insured population would be drawing benefits within a few decades if the incidence rates were assumed to increase 6% annually. It was, therefore, decided to establish an ultimate set of incidence rates at a level 16% higher than the 1974 experience. This was done with the expectation that within the next few years we would gain a better understanding of the causes of past increases and institute the changes needed to stabilize the future rates. We chose to approach the 16% ultimate level by assuming equal increases of 3% in each of the next five years. This approach could be modified without significantly affecting the long-range cost estimates, for example we could have assumed the ultimate level would be attained as a result of a 5% increase each of the next three years.

If the disability incidence rate were increased by six percent per year for each of the five calendar years 1975-79, we estimate that the disability insurance trust fund would be exhausted in 1978. In the 1975 Trustees Report, by contrast, we estimated that the disability insurance trust fund would be exhausted in 1980. The average long-range cost of the disability insurance program would be increased from 2.97% of taxable payroll to 3.40% of taxable payroll, or by about 14% relatively.

Mr. ARCHER. As you know, there is a case presently pending before the Supreme Court, *Weinberger v. Eldredge*, to be argued in the fall term.

Mr. CARDWELL. Yes, sir.

Mr. ARCHER. It relates to the requirement of predetermination hearings for disability insurance beneficiaries. Could you tell us whether the State disability determination agencies, the SSA and the Bureau of Hearings and Appeals, will be able to absorb the workload that would be created if the decision in this case is favorable to the respondent?

Second, have you done any planning with respect to this contingency?

Mr. CARDWELL. We have done a lot of worrying and I will be frank that I think the outlook is that our chances are not very good of winning that case. Our general counsel at least, doesn't think they are.

The answer to your basic question has to be that somehow we will have to do it. No is just not an acceptable answer. It is going to send us over into another tailspin. I can assure you of that. It isn't something we are going to solve very easily by just planning or by just adding numbers of people. Let's look at what is involved. We will have to take more time on each claim and that is because this is just going to increase the processing time. We can add staff at the State level and start to train them. In that regard we do have seven States that are now engaged in an experiment modeling this method to see how it works and what the real requirements would be.

Where the real problem, will show up, is that this is going to very quickly impact further on the hearings and appeals process. I do not think that the arrangement that we must work under, under the Administrative Procedure Act, lends itself to easy solution at least by just adding people. There are not enough people in the general population who can qualify as administrative law judges available to us in the numbers that we now need to do our basic work, the work we already have.

If this process does impact on the hearings and appeals process, as I think it ultimately will, it is just going to compound the problem.

In summary, we are doing some planning. As I say, we have the experiments underway in seven States and I can give you the list of States. We also know that if the court so rules we will have to figure out a way to do it, but it is obviously going to add a dimension to our already impacted workloads, a significant dimension, just as the *Buffington-Biner* case that I mentioned will and as all the other cases that are now beginning to build in the courts involving due process.

Social security is about to go through the same experience that the State welfare agencies went through starting a decade ago. It is interesting that this concept of due process that has affected the State public welfare programs is really so late in showing up at the Federal level because there is a direct similarity and relationship between awarding a social security benefit or any other kind of benefit.

I think the handwriting is all on the wall. We are going to be required to provide opportunities in advance for some kind of informal hearing at least every time we affect the claimant's rights or a beneficiary's rights. If we made an error and overpaid a person, say a

horrible error, gave somebody obviously too much money, for example, we will not be able to correct that error until we have given that person an opportunity to prove that we are right in making our decision.

We are an agency that has through the years developed all of our work processes around the computer. This concept of due process involves face-to-face encounters with people and computers can't do it very well. We give out notices to people that are pretailored. They are canned notices. We anticipate certain conditions and program the computer to crank out a notice automatically, "We have just reduced your check because we overpaid you last month."

This requirement for due process that we think we see in the offing will change all that. We won't be able to handle it so easily by the computer. I think the prospects are that we are going to face a larger and larger social security work force whether we like it or not.

Mr. ARCHER. I thank you very much, Commissioner.

My time has expired.

Mr. CARDWELL. I am sorry. I used too much of it.

Mr. COTTER [presiding]. Mr. Commissioner, on page 19 of the trustees report it shows that the cost of administering the disability program as a percentage of contribution income and benefit payments was reduced considerably from 4½ to 2½ percent, this is also reflected on page 20 which shows that the gross administrative expenses for the disability insurance program vary from \$246 million in fiscal 1973 to \$154 million in fiscal 1974.

What is your interpretation of these figures?

Mr. CARDWELL. I will ask Mr. Crouch, who is the Acting Director of the Bureau of Disability Insurance to answer that.

Mr. CROUCH. I am not really sure I fully understood the question.

Mr. COTTER. There is this drastic reduction both in money and in percentage, from 4½ to 2½ percent. I am not sure whether this indicates more efficient administration or possibly curtailment in the activities in administering the program.

Mr. CROUCH. With respect to the levels of staffing that are devoted to the disability program it certainly doesn't reflect any significant change in that. There has been some reduction.

Mr. COTTER. You are talking about \$90 million in a 1-year period and a reduction percentagewise of 2 points, from 4½ to 2½ percent. Are you doing less work in this area?

Mr. CROUCH. This is related to benefit cost, isn't it? This is a percentage related to a benefit cost?

Mr. COTTER. Right.

Mr. CROUCH. I think it is probably more related to some change in the relationships of cost to benefits rather than any administrative change. I am not sure that I am aware of any administrative change that would account for that kind of difference in relationship.

There has been some reduction over time in the amount of money. The most significant thing I can think of is the amount of money spent for medical evidence because we have been able to rely more heavily on evidence from treatment sources. I don't think it would account for that kind of difference.

Mr. COTTER. Do you have a copy of the trustees report?

Mr. CARDWELL. We did not come prepared to talk to the trustees report but let me point out that if you look at all of SSA's administrative costs in their relationship to either benefits or contributions they have all dropped slightly during that period, regardless of program.

Mr. COTTER. But you look in 1970 where it goes in benefit payments from 5.3 percent down to 2.5 percent in 1974 and it is dropping slightly each year and then you have a big drop in 1974.

Mr. CARDWELL. Taking the other programs by comparison, in retirement and survivors insurance there was no change.

Mr. COTTER. No change?

Mr. CARDWELL. No significant change in that one area.

Mr. COTTER. It was insignificant?

Mr. CARDWELL. Very insignificant. That is the only one that shows the drop. I would just have to look into that and I am sure it is a result of an analysis made by the actuaries and we will speak to this in the record. That is all I can do.

Mr. COTTER. It is big in dollar amount and in percentage drop as well. Are you doing less work in the particular area?

Mr. CARDWELL. Definitely not, no. There has been, we think, some improvement in the productivity in the State agencies during this period but it couldn't account for that much money.

Mr. COTTER. Without objection, if you would submit it for the record I would appreciate it.

Mr. CARDWELL. Yes, sir.

[The material follows:]

EXPLANATION OF THE SIGNIFICANT DECREASE IN YEAR-TO-YEAR ADMINISTRATIVE EXPENDITURES FROM THE DISABILITY INSURANCE TRUST FUND AS REFLECTED IN THE 1975 OASDI TRUSTEES' REPORT

To understand the reasons behind the decrease in disability trust fund administrative expenditures as reflected in the 1975 OASDI trustees' report, and to view properly the real costs of disability functions performed in SSA under title II of the Social Security Act, it is necessary to make a distinction between total administrative expenditures for disability operations and administrative expenditures from the disability insurance trust fund. These concepts, which appear to be the same, are not. Total administrative expenditures for disability work involve those expenditures related to processing disability claims and appeals of SSA decisions on those claims, paying checks to program recipients, and otherwise maintaining the roll of beneficiaries who have established entitlement to disability insurance benefits. On the other hand, administrative expenditures made from the disability insurance trust fund in a given year are influenced by (1) the manner in which funds are drawn out of and adjusted among the four social security trust funds for administrative purposes, and (2) the cost allocation (program cost accounting) principles used in charging the costs of disability operations to the several trust funds. The following explains: (I) the real growth in disability operations costs in recent years, and (II and III) the causes for the drop in cash flow from the disability insurance trust fund for administrative expenses.

I. DISABILITY OPERATIONS GROWTH

The growth of title II disability operations and obligations for administration in SSA in recent years is highlighted in Table A. The table shows increases that have occurred in major disability workloads, and in obligations charged to SSA's salaries and expenses appropriation for disability operations for the period FY 1970-1974.

TABLE A.—SSA TITLE II DISABILITY OPERATIONS

Fiscal year	Major disability workloads (thousands)			Obligations incurred ¹ (millions)
	Initial claims processed	Appellate claims processed	Beneficiaries maintained	
1970.....	1,135	163	2,562	\$187
1971.....	1,396	203	2,733	228
1972.....	1,428	229	2,999	273
1973.....	1,469	245	3,314	293
1974.....	1,690	271	3,599	338

¹ These obligations are charged to the disability activity included in limitation on salaries and expenses, SSA.

II. MANNER IN WHICH FUNDS ARE DRAWN OUT OF AND ADJUSTED AMONG THE SOCIAL SECURITY TRUST FUNDS

Because many of the functions which SSA performs in administering programs for which the Congress has made it responsible are significantly integrated, the specific costs attributable to each separate program are not clear-cut or easily identified. For example, the same district office personnel often take OASI, disability, and SSI claims. During the year, administrative expenses are drawn from each trust fund based on SSA's best estimate of the allocation of such costs among the trust fund programs. Once the year is over, and after analyzing the work actually performed and costs actually incurred, on the basis of work measurement systems, SSA determines the final allocation of administrative expenses by trust fund. Based on this determination, an adjustment is made among the trust funds to assure that each has borne its proper share of administrative expenses. Thus, each year's expenditures from a trust fund for administrative costs (as presented in the annual trustees' reports and the Federal budget) are separated into two distinct components:

1. The preliminary allocation of that year's administrative expenditures,

2. An adjustment which is related to the prior year's administrative costs. Since the trustees' report shows trust fund transactions on a cash-flow basis, it does not identify each year's final allocation of administrative expenses. In order to convert the trust fund's net administrative expenses in each year (as shown in the trustees' report) to the trust fund's final allocation, one must reflect the adjustments in the year to which they apply rather than in the year in which they are charged to the trust funds. Table B makes this conversion for administrative expenses of the OASI and DI trust funds:

TABLE B.—OASI AND DI ADMINISTRATIVE EXPENSES

[In millions of dollars]

Fiscal year	Administrative expenses (outlays) ¹	Less adjustment for prior year	Preliminary allocation	Plus adjustment in following year	Final allocation
OASI trust fund:					
1970.....	474	-13	487	(²)	486
1971.....	552	(²)	552	-7	545
1972.....	582	-7	589	11	600
1973.....	667	11	656	12	668
1974.....	723	12	711	43	754

¹ Shown in trustees' reports.

² Less than \$500,000.

DI TRUST FUND

Fiscal year:	Net administrative expenses (outlays) ¹	Less adjustment for prior year	Pre-liminary allocation	Plus adjustment in following year	Final allocation
1970.....	149	4	145	7	152
1971.....	190	7	183	4	186
1972.....	212	4	208	11	219
1973.....	247	11	236	-44	191
1974.....	154	-44	198	13	212

¹ Shown in trustees' reports.

Based on the final allocations of administrative expenses shown above, one can see that for the disability insurance trust fund there was an increase of \$21 million from the 1973 level to the 1974 level. However, the table does show a year-to-year decrease of \$28 million from 1972 to 1973. This decrease does not indicate a curtailment of activities in administering the disability program. Instead, it is a result of the changes in cost allocation policy which are discussed in section III, to follow.

The table on page 19 of the OASDI trustees' report, which displays administrative expenses as a percentage of contribution income and of benefit payments, also is based on net administrative expenditures (i.e., cash flow), rather than the final allocations of administrative expenditures. Table C compares the ratios shown in the trustees' report with those which would result from using the final allocations of administrative expenses instead.

TABLE C.—OASI AND DI ADMINISTRATIVE EXPENSES AS A PERCENTAGE OF CONTRIBUTION INCOME AND OF BENEFIT PAYMENTS

OASI TRUST FUND (In percent)				
	Based on net administrative expenses		Based on final allocation	
	Contribution income	Benefit payments ¹	Contribution income	Benefit payments ¹
Fiscal year:				
1970.....	1.6	1.8	1.6	1.9
1971.....	1.7	1.8	1.7	1.8
1972.....	1.6	1.7	1.7	1.7
1973.....	1.6	1.6	1.6	1.6
1974.....	1.5	1.5	1.6	1.6

¹ In determining the percentage shown, payments for the cost of vocational rehabilitation services are included with benefit payments.

DI TRUST FUND (In percent)				
	Based on net administrative expenses		Based on final allocation	
	Contribution income	Benefit payments ¹	Contribution income	Benefit payments ¹
Fiscal year:				
1970.....	3.6	5.3	3.7	5.4
1971.....	4.2	5.6	4.1	5.5
1972.....	4.4	5.2	4.5	5.4
1973.....	4.5	4.7	3.5	3.7
1974.....	2.5	2.5	3.4	3.4

¹ In determining the percentage shown, payments for the cost of vocational rehabilitation services are included with benefit payments.

III. COST ALLOCATION PRINCIPLES USED IN CHARGING DISABILITY OPERATIONS COSTS TO THE DISABILITY INSURANCE TRUST FUND AND TO OTHER TRUST FUNDS OR PROGRAMS

The programs SSA administers are highly integrated both in terms of how operations are carried out and in terms of the interrelationship of entitlement factors legislated in various amendments to the Social Security Act. This interrelationship was reflected in cost sharing principles established at the time the disability insurance program was first enacted and the DI trust fund established. At that time, it was determined that a part of the costs involved in operating the new disability insurance program should be borne by the OASI trust fund on the basis that the process by which a person became entitled to disability insurance benefits also entitled that person to retirement benefits through an automatic conversion process when he or she turned age 65. However, under the principles established at the time, only costs related to approved disability insurance claims were shared between the two trust funds. Costs related to denied claims were borne solely by the disability insurance trust fund.

Subsequent to the enactment of the disability insurance program, other programs have been enacted which are in various ways integrated and related to it, and which have added considerable complexity to cost accounting methods used to allocate costs to each program. Chief among them were Medicare for the disabled, and the Supplemental Security Income programs, both of which were enacted in FY 1973 and became operational in FY 1974. To appreciate the complexity caused by these added programs, the following illustration is offered: A person who files a title II disability insurance claim will potentially be entitled to 1) title II disability insurance benefits if the claim is allowed, 2) Medicare benefits after two years have elapsed, 3) retirement insurance benefits at age 65, and 4) supplemental security income benefits if his income and resources are low enough to qualify him for same. Each of these entitlements are dependent wholly or in part on the one disability entitlement determination. Therefore, proper application of cost accounting principles requires that each of the programs share in the cost of the entitlement determination.

When Medicare for the disabled and the Supplemental Security Income program were enacted, a re-evaluation was made of the principles and procedures used in determining how costs are charged to SSA programs. As a result, new principles went into effect for FY 1973, for the programs then in operation. Reflected in these principles was a decision to allocate the cost of processing disability insurance claim denials among all of the programs affected by disability determinations, rather than charging the denials wholly to the disability insurance trust fund. This decision was the most significant factor causing the \$28 million decrease from FY 1972 to FY 1973 in the final allocation of administrative expenses to the disability insurance trust fund. The change was adopted based on the principle that a denial of disability insurance benefits is also a denial of future Medicare for the disabled benefits, and a denial of a modified benefit computation taking into account the period of disability, which would affect the amount of future monthly retirement or survivor's insurance benefits. The \$28 million drop in the DI trust fund's final allocation of administrative expenses that this change produced from 1972 to 1973 results in a large one-time decrease in the ratios of disability, insurance trust fund administrative expenses to benefits and to contributions—as demonstrated in tables B and C.

In FY 1974, the application of cost sharing principles to the new Medicare for the disabled and Supplemental Security Income programs (which were not in effect during 1973) created a further drop in the ratios of administrative expenditures to benefits and to contributions, as reflected in Table C.

Mr. COTTER. Thank you very much.

Mr. Steiger, would you want to inquire?

Mr. STEIGER. Thank you, Mr. Chairman.

If I can, Commissioner, let me go to some points in your statement. No. 1, on page 6 you talk about the program centers. I wonder if you would fill me in a little bit about from whence sprung that concept and how do they work and why did you establish what it seems to me approaches an overlayer on top of an overlayer on top of an overlayer? What is the program center all about?

Mr. CARDWELL. Well, the program center is probably one of the oldest organizational arrangements in the social security program. It goes back almost 40 years.

I certainly am not that expert on its origins but the idea is that the local offices, the intake points, the point at which the claimant makes his initial contact with the Government, would concentrate on taking the claim, obtaining all the necessary information and that we could more efficiently collect and concentrate the adjudication of those claims and the preparation for the initial payment and then the re-examination and adjustment of those claims after the fact.

There are six such centers around the country. They employ in the aggregate about 13,000 people. The basic records on everybody in payment status on the program are maintained in those six centers and not at headquarters in Baltimore nor in the 1,300 individual local

offices. The idea is having regionalized, really, the six centralized regions of the country in the adjudicative and payment processes. In the long term, the prospects of being able to use computers on line suggests that maybe someday the program center will become outmoded and that the process could function from the local office and through the central computer in Baltimore.

We are just now putting together what we think will be a maximum effort, if the President approves it, to engage in about a 5- or 6-year project of overhauling our whole process, the whole business of how we take claims, how we adjudicate them, how we maintain records and how we execute payments because we are reaching the conclusion that the present methods are just beginning to wear down.

Just as 30 years ago business and Government came to realize that you couldn't do all the things we were trying to do on paper and the computer bailed us out, we are now realizing that the traditional methods of processing—whether computer or manual—are not able to provide the level of service which our beneficiaries deserve. We need to move to methods of processing, including online computer systems and things of that sort, which allows us to take prompt action on all cases, including the more difficult ones.

Mr. Marquis, who has been with the agency many years and may at one time have even worked in a program center, can answer the question if my answer doesn't satisfy you.

Mr. STEIGER. I will come back at you, Commissioner, with some specific details based on my own office's experience. That is my reason for following this line of questioning.

We are experiencing at this point a relatively significant increase in response time by the Chicago Payment Center, and the Baltimore office, not just for disability but for regular status reports on the particular individual involved and his or her account. That is a matter of some concern to me. The delay even in initial responses from the Baltimore office of social security is a problem which over the last 18 months has grown tremendously.

I am going to come at you just from my standpoint with some specifics on the elapsed time between when I send it and when I get an initial response and the incredible delays that have taken place in some of the cases before any kind of final determination is made. My only reason for asking at this point is that it seems to me that it may have been understandable at one point to go into the regional concept but I have a feeling that we are falling through the cracks at this point and that the capability of the local office in the Sixth District of Wisconsin has improved dramatically. They are doing a far better job and they are having worse problems than I am having in trying to get anybody to pay attention to some of the kinds of cases that they are covering.

I will come back at you with some specifics.

Mr. CARDWELL. May I make three quick points? You are experiencing what literally every Member of Congress is experiencing and most of you have so stated in sometimes very vigorous letters. I think three things are to be said.

One, I think you are reading about 6 months behind the times. I really do think the record shows that things are better. I don't want to suggest that they are that much better.

Second, you are realizing a phenomenon that has been building for a long time and you are just now realizing it. That is the scale of this program. If we operate at 99.99-percent pure and made errors at only a one-tenth of 1 percent rate, you would be dealing with about 400,000 erroneous cases a year. We are not that good and are never going to be close to that. So it tells us that the sheer size of this program now is affecting every Member of Congress. We are the biggest user of your time, your casework time. There is no other program which can touch us, I am sure. One has to realize that out of 30 million, 40 million, 50 million cases there are going to be a number of horrible examples at any one time.

The third point to be made is that we became tremendously impacted about 18 to 24 months ago and we are still impacted. What I have tried to show in my statement and I think we can fill the record with data which will show, except in the hearings and appeals cases, that we are gradually improving. It is the same kind of steady improvement from peak workloads which occurred about a year to a year and a half ago.

So that those three points I would underscore. There are a lot of horrible examples. I see them, I am sure, more than you do.

Mr. STEIGER. I understand very well the complexity and magnitude of the problem.

Mr. CARDWELL. We are now trying to plan to overhaul our system but it is going to take 5 to 6 years to redo them completely. There is no way we can turn this thing around overnight. It is going to take hundreds of millions of dollars.

Mr. COTTER. The gentleman's time has expired. Mr. Jones will inquire.

Mr. JONES. Thank you, Mr. Chairman.

Mr. Cardwell, by your testimony, you certainly pointed out that the Social Security Administration is into a number of areas that far exceeds its traditional role, such as black lung, pension reform and many others. It seems to me that there is a limit to your capacity to administer any more programs.

What I am asking of you is, what can Congress do legislatively or otherwise, to help you to better go about your primary social security role?

Mr. CARDWELL. There are a lot of ironies that I think are present in any answer to that question. One is that we are in the fix we are in today partly because we were very good in the past, and people continually developed confidence in us and didn't hesitate to assign new work to us. I think one of the strengths of our system of government is that we tend to approach problems as if we can solve them and the fact that we approach them that way in the final analysis, helps us do many things that we wouldn't otherwise do.

I don't want to be negative. On the other hand, I do agree with you that we have taken on too many things during one fixed period of time. We didn't say, don't ask us to do this or that. Instead, we did what most dutiful people or groups of people do. We said, "We'll try to do more." I don't want to depart from that spirit or principle. We will continue to try to do more. If I were sitting on the other side of this table, and I were thinking about the future, I would be quite convinced from the social security experience that we need to allow

more leadtime when we install new activities. Our political process doesn't tend to want to wait for that. It is afraid that something will change, if you allow leadtime.

All the political pressures are to enact something and make it effective immediately, but SSI, which theoretically had 18 months of leadtime, did not provide enough leadtime to the executive branch and even with the leadtime that was available the Congress changed the law three times in the process. In fact, one of the changes occurred in the first month of the program. It was a retroactive change that we couldn't even carry out. My answer to your question is, "Think twice before you assign a new workload and even then, when you do decide to go ahead and do it anyway, provide some leadtime."

Mr. JONES. You indicate in your testimony that the processing time, your computer operations and all, for SSI, are being straightened out, that you are going to get them straightened out. When are they going to be functioning to the point that they are functioning relatively smoothly?

Mr. CARDWELL. Well, I would say a year-and-a-half.

Mr. JONES. One of the things in our district, with regard to SSI that may be peculiar to our district, is the fact that you don't have assigned caseworkers to cases. We have had a number of complaints where people come into the offices there, and their files can't be found and the person they talked to last time is not there to talk to them this time and they have to go through the process all over again.

Is this a kind of national problem?

Mr. CARDWELL. Yes.

Mr. JONES. Is this something that you can straighten out?

Mr. CARDWELL. It is a national approach to the way the program functions. The assignment of work is really patterned after the basic social security experience, which does not assign a block of cases to a claims representative.

The income maintenance programs administered by the States, are usually centered on caseworkers, usually social workers who are assigned so many cases.

We have organized, and this is the traditional pattern of social security, around the concept of a generalist who would deal with a medicare claim, an SSI claim, a retirement, survivors or disability insurance claim, as well as an application for a social security number. One of the things we must look at again and again is whether that is the right approach. Many of the State welfare agencies have been critical of our approach and think that theirs is the better approach.

Mr. JONES. You could still have your people as generalists but yet they would be assigned to a particular precinct and handle that case and all the ramifications of that case.

Mr. CARDWELL. Well, the number would eventually be very, very large for one worker. The whole system requires the file in the case to be maintained some other place. The heart of the case almost always leaves the local office. The claims representative will process thousands of cases across his desk in a year and there is hardly any way that he could be accountable for all those cases. That doesn't mean to say that it's impossible to organize around caseworkers in the office. I don't want to say we couldn't.

Mr. JONES. Are you going to be studying that?

Mr. CARDWELL. Yes, sir. The results of any study will be submitted to the subcommittee.

Mr. JONES. You could give us a report on that.

Two other questions, Mr. Chairman, in the 2 minutes I have remaining.

Mr. COTTER. The gentleman will continue.

Mr. JONES. This has to do with the administrative judges and the hearing commissioners. I have had some complaints that you have some law judges and hearing commissioners with not much to do, and this is in the black lung area, in some cases, even though we have many pending cases and that there ought to be some legislative changes in that whole concept to better direct the load.

Do you have any suggestions in that regard?

Mr. CARDWELL. We have worked a great deal in the last year on that subject and can still do some more work on it. The distribution of cases and assignment to law judges, the issue of moving the cases to the judge or the judge to the case had become more complicated than it seems to me it should have.

Part of it, I think, has to do with the way we organized these judges in the first place and the way the Administrative Procedure Act has caused some of them to believe they are somewhat autonomous and independent of the agency of which they are a part, and thus, have the option and opportunity and the right to set their own pace.

That, I think, is where this problem you speak to, really starts. We are just going to have to become their supervisors even at the risk or appearing to interfere with their decisions which we certainly will not do. They must be supervised, must be assigned cases. We must have some means of gaging their work and must have some additional organizational arrangements on which we are now working.

Mr. JONES. Would this necessitate legislative changes?

Mr. CARDWELL. I don't think that is a problem that requires legislative changes. The legislative change issue would center on where anyone wants to modify the basic skills and use skills other than administrative law judge, and my answer is that it is too late to consider that. If I could start all over again, that is what I would do, but it is too late.

Mr. JONES. On the *Buffington-Biner* case that you referred to on pages 7 and 8, you indicate that you are going to set up in August, three cites for these personal conferences.

What are you going to be doing in the interim, while this case is pending, and you are requesting a moratorium? What are you going to be doing in that interim period with regard to recoupment of overpayments?

Mr. CARDWELL. Well, that I think is really the heart of our problem. The most we can do is to keep a running record of the overpayments and be sure that we are giving the individual notice.

In the new cases, as they occur, we are going to have to start moving toward some form of hearing opportunity and we are just now looking at ways to do that. Recognizing that these local offices are already heavily impacted and that is where it has to occur, it is going to require training and things like that so that we are going to be working on plans to carry it out.

Mr. JONES. You are developing a new additional backlog of work?

Mr. CARDWELL. Right.

Mr. JONES. Thank you, Mr. Chairman.

Mr. COTTER. Thank you.

Mr. Crane will inquire.

Mr. CRANE. Thank you Mr. Chairman.

Mr. Commissioner, I would like to make a couple of brief observations based upon the experiences we have had in my office and I doubt that they are peculiar.

First, let me pay credit to the cooperation, the assistance and the overall general efficiency shown in dealing with the Social Security Administration in Washington, and I do not intend to register criticism, either, against caseworkers. But down at the district office level clerk inefficiency has been a chronic problem in the 5 or 6 years I have been down here. A good deal of it seems to be a problem of losing records with incredible consistency.

In addition to that, in the case of disability payments, often times we have had instances where a person has had to go back to the same doctor three and four times to get the same medical reports. I am not sure whether they lose the first three and the man has to get a fourth, but even the physicians get a little exasperated. I understand those clerks are about a G-5 level.

Mr. CARDWELL. Well, the claims representatives generally are college educated people who start out at grade 5 and there is a ladder of development that they can track. As we said earlier, they are trained to become generalists and become expert in the requirements of the basic programs. I think Mr. Steiger's point is the point to consider. He asked whether we have organized the work properly because the fact is that the local representative is not charged with the followup on each case. The worker has to go to some other site to obtain the file or information about the file. As a result, he refers the inquiry to another point. That is part of the problem you point to.

There is an axiom in the business that says that when you are dealing with several hundred million files, once a file gets lost, there is a good chance it is either going to stay lost or get lost again. There are all kinds of case-control regimens that have been designed through the years to prevent this, but it still happens. When backlogs build, a snowballing starts to take place. The claimant starts to complain and comes to the agency about his case. The file is pulled and that takes it out of its ordinary rhythm and routine and some element or risk begins at that point.

The individual goes to his Congressman. He calls. He writes a letter. The case is pulled. Maybe it was still out when the letter came in. If he doesn't get an answer to his letter, he writes again and before you know it, you start the snowball. That is obviously part of our problem.

Mr. CRANE. You are talking about within the SSI part of the program?

Mr. CARDWELL. No, I am talking about anywhere.

Mr. CRANE. You have a backlog across the board?

Mr. CARDWELL. We have had backlogs essentially across the board. They peaked, we think, about a year ago, and we think they are steadily coming down, but they still exist in some dimension across the board. The only area where they are still building up is the hearings and appeals process.

Mr. CRANE. Let me throw out a suggestion. You indicated the lowest level of these clerks that you employ are college graduates. Is it a requirement that they have a college education?

Mr. CARDWELL. Yes, sir; usually.

Mr. CRANE. Is it not conceivably desirable to employ high school graduates who may be more highly motivated at that level of work? Perhaps you have overeducated people?

Mr. CARDWELL. If a high school graduate can qualify for the examination, he can have the job. Often he cannot pass the examination.

Mr. CRANE. Maybe you ought to reevaluate the examination. Going back to World War II, they found a lower accident rate in many of those tasks requiring more mundane, routine performance with people who did not have as high an educational level.

Mr. CARDWELL. I don't think that is where the problem lies. I think the higher the general educational level, the more sensitive these people are to the myriad problems that individuals can have. The motivation and willingness to respond at the local level is very high. In fact, that is where our best performance occurs.

Mr. CRANE. That is not our experience.

Mr. CARDWELL. But, you are identifying it with the worker. You should be identifying it with the record and the way the work is organized, rather than with the individual. I think you are faulting the wrong person when you fault the local claims representative, because he can't answer your question. He was never prepared to answer it in the first place.

Mr. CRANE. Let me ask you another question.

What is your turnover rate of personnel? How does it compare at various levels?

Mr. CARDWELL. It is roughly better than Government at large. I can't give it to you off the top of my head. It will vary from place to place, according to the kind of work involved. The turnover rate among the young people coming in new, is fairly high, but that is true in industry, as well as the rest of Government.

Mr. CRANE. I may have caught you off guard here, with a question that you don't have the information on, but could you, for the record, provide a breakdown of what the turnover rate is, at various levels for us?

Mr. CARDWELL. Right.

Mr. CRANE. Thank you, Mr. Commissioner.

I yield back the balance of my time.

[The material follows:]

RATES OF SEPARATION¹ OF EMPLOYEES IN THE SOCIAL SECURITY ADMINISTRATION, BY GRADE, FISCAL YEAR 1974

GS grade	Total SSA	SSA headquarters	Field offices (including local offices)	Local offices only
1-----	² 118.1	15.2	² 131.6	² 134.1
2-----	49.3	45.2	51.9	34.1
3-----	14.5	11.7	16.8	16.5
4-----	9.5	8.6	10.0	11.4
5-----	9.2	6.3	10.3	10.4
6-----	4.8	3.4	5.2	5.4
7-----	6.2	6.2	6.2	4.1
8-----	4.2	3.4	4.4	0
9-----	4.6	4.4	4.6	6.2
10-----	4.9	5.1	4.9	5.0
11-----	2.8	3.1	2.7	2.2
12-----	3.3	3.4	3.2	2.5
13-----	2.8	2.6	3.2	3.4
14-----	3.9	3.9	3.8	6.5
15-----	4.7	5.5	4.1	5.5
16-----	7.6	3.2	22.2	0
17-----	8.3	8.3	0	0
18-----	0	0	0	0
Total-----	11.0	9.1	12.0	11.8

¹ Separations include quits, transfers of SSA employees to other Government agencies and to other DHEW constituents, discharges, retirements, deaths, and separations due to declined relocation, declined assignments, disability, reduction in force, displacement, expiration of appointment, military, lack of work, and lack of funds. The formula for the calculation of the separation rate is the number of separations divided by average employment and multiplied by 100. For each fiscal year, average employment is calculated by adding the employment figures for periods June 30 (end of previous fiscal year) Sept. 30, Dec. 31, Mar. 31, and June 30 of fiscal year concerned and dividing by 5.

² The high separation rate for GS-1 employees is the result of the claims assistance program in the local offices. This was a special program necessitated in fiscal year 1974 to meet SSI claims work loads. Employees were hired for temporary positions at the GS-1 level to assist SSI claimants in local offices, and were separated when their services were no longer needed.

Mr. BURKE. Mr. Steiger.

Mr. STEIGER. Thank you, Mr. Chairman.

Could I go to a point made with Mr. Crane? You have given us on page 13, the backlog on hearings and appeals. You have indicated that there are 110,000 hearing cases awaiting action.

Do you have an estimate at this point, or can you give us one on what the time delay is on the backlog of hearing cases?

Mr. CARDWELL. I want to turn the question over to Mr. Trachtenberg, the Director of the Bureau of Hearings and Appeals. I would start out by saying one thing, that if we didn't receive another case for 1 whole year, we would still have a case level at the end of the year. Does that tell you something?

Mr. TRACHTENBERG. Congressman, the goal that I set is to be out of the crisis situation, in terms of the backlog by the end of fiscal year 1977. That means that we would have about a 40,000 to 50,000 case backlog. There will always be some backlog, because not every case is ready for hearing at a given moment. The case needs to be developed, and a variety of other things need to be done. The median processing time, now, on the average is over 200 days.

Mr. STEIGER. The median processing time for a case for a hearing?

Mr. TRACHTENBERG. That is right. That is from the date of the request for the hearing to the actual decision.

Mr. STEIGER. 200 days?

Mr. TRACHTENBERG. More than that. It is 210 days.

Mr. STEIGER. That is incredible, I must say. There was a story in the newspaper about the law judges going to Puerto Rico. What happened with that situation?

Mr. TRACHTENBERG. Well, I think that tells one part of the story. It is true that the administrative law judges had been going to Puerto Rico to hear cases. They heard in a 2-week period an average of about 40 cases. Puerto Rico, which is part of region II, is the highest backlogged area in the entire region. Therefore, it was just absolutely essential to get people down there to hear cases, because the delays there were considerably higher—running close to 240 days.

It was clearly the highest, as I said, in region II. I instituted some changes in this area, when I came aboard in January, long before the GAO study came out. I made it clear that only administrative law judges from region II would go to hear cases in that area, because it was a regional problem. We made sure that in no event would a law judge go there, if the backlog in his office was anywhere close to that in Puerto Rico. The problem continues to be the need to send additional judges down there. One of our problems is the difficulty in getting individuals who are interested in working full time in Puerto Rico as administrative law judges.

Mr. BURKE. Would the gentleman yield?

Mr. STEIGER. Yes, of course.

Mr. BURKE. I might make the observation, Mr. Steiger, that you are a member of the Task Force on Oversight. It might be necessary to send you down to Puerto Rico next winter to look into this matter.

Mr. STEIGER. That is the nicest offer I have had in a long time, but that doesn't help those in Waushara County, who are experiencing a delay longer than in Puerto Rico.

Mr. TRACHTENBERG. I doubt that that is true.

Mr. BURKE. Would you suggest that they go out in snowmobiles?

Mr. STEIGER. Yes; they have a snowmobile festival in February each year.

Mr. CARDWELL. Mr. Steiger, I really doubt that your constituency has a greater backlog than Puerto Rico. Puerto Rico has a very large concentration of poor people. As Representative Patsy Mink once said to a Member of this body, when they were complaining about somebody taking a trip to Hawaii, it is all part of the United States.

I don't think going to Puerto Rico, personally, is that great a lark. The issue here really centered on an assumption that in the past, the Bureau of Hearings and Appeals had permitted judges from other parts of the country to go to Puerto Rico, during the warmer months as a reward. That is not now taking place. It might have taken place in the past. I don't know. If so, it was in the past. Puerto Rico is a territory that we are responsible for, and it is part of region II. It has a heavy workload, and we have to send people back and forth. We have no choice.

Mr. STEIGER. I understand that. I raised it because I thought there was an explanation, and I am delighted that you are limiting it to region II, which seems to me to be the most simple way to do it.

Mr. CARDWELL. We had not seen the GAO report before it was publicized.

Mr. STEIGER. When that hit the papers, it created sensitivity from areas that do not have quite as much to offer as Puerto Rico has to offer, sometimes.

May I go to another question on the disability program? The law is structured, as you know, and you referred to it specifically on page 9 of your statement with the State rehabilitation agency, which operates under a contract with your office. Is that system working well? Are you satisfied with that process, through which these claims now go?

Mr. CARDWELL. That is a question that has been asked so many times by groups and interests outside of the agency. It has been asked steadily by the agency. As of this moment, we in the agency feel that it is working as well as it could work, and we wish that our part of the process, frankly, were in as good a shape as we think their process to be, generally. The State agencies have steadily improved their performance. They seem to be carrying out their work fairly efficiently, all things considered. All things considered, the first question that must continue to puzzle us and which we must, I think, continue to look at is the basic difficulty of having to have a second party carry out part of the process at arm's length, for fear that the first party might not be as objective or something, whatever leads to that original conclusion.

I think it is undeniable that the business of trafficking in paper back and forth has to prolong the basic process. I don't see how it could be any other way although not everybody agrees with me on that. I start out with that general feeling.

Our examination of their performance tells us that our problems in the last year or 1½ years in disability of have not centered there. The problems lie in our own internal procedures, the matter of making payments once the claim had been adjudicated, interrupted payments and that sort of thing.

Most of the horrible examples that you probably experienced, really center on those latter processes more often than not, rather than on the former process of the State agencies' delay.

Mr. STEIGER. Actually, there have been very few "experiences" which interested me. That is one reason I wanted to ask you that question. It does, I would judge, have to have some impact on the delay question and the additional paperwork that is required. But I wanted to have your own judgment as to whether that system by and large, given the complexity of, it, is working well, and I appreciate your answer.

Mr. CARDWELL. In our opinion, it is, and we keep it, frankly, under constant pressure, because our reputations follow their performance.

Mr. STEIGER. Mr. Chairman, thank you very much for giving me a little extra time. I would want the Commissioner to know that I am sure every member has had experiences with the Social Security Administration, and it is an incredibly large responsibility that you have. Not only the fact, that it involves exceedingly complex medical questions, when you get into the disability area, but the financial question of the person who doesn't get the check on time, makes your job that much more difficult.

I must say I am impressed by what you and your staff have been able to do, by your candor and willingness to come here. I would hope the establishment of the Social Security Subcommittee on the part of the Ways and Means Committee might mean that we will do a better job than, frankly, I think the the House has done in trying to help you and us to do that job.

Mr. CARDWELL. So far, so good. I think there is great promise that that is exactly the way it will work.

Mr. BURKE. I think it will work out very well. In fact, I had the good experience of taking a trip to Baltimore, and I am suggesting that most of the members of the committee do the same.

Mr. STEIGER. I think we should, just to see that Pentagon East.

Mr. BURKE. It is a tremendous operation. It requires a man of ability, and the Commissioner seems to have that ability. It is an awesome responsibility. Most of our congressional mail is on social security.

Mr. CARDWELL. Mr. Chairman, at some risk to my reputation, I would remind the record that most of the bad things seem to have started to happen about 18 months ago, and that is when I went to SSA.

Mr. STEIGER. That is because we kept changing the law.

Mr. CARDWELL. That is what I keep telling myself.

Mr. BURKE. We have piled a lot of responsibility on to you.

Mr. STEIGER. We have a television star here, today, with the chairman of the subcommittee for his appearance on the "Today Show," making one of his usual nonpartisan analyses of the administration's position. I am fascinated, Mr. Chairman, by your view.

Mr. BURKE. It might result in bringing us together.

I want to commend the Commissioner and those who accompanied him on the panel here this morning. You have made a good presentation, and you have given the committee and also the staff something to look over and study to make us more aware of what the problems are.

The committee now stands adjourned, subject to the call of the Chair.

Mr. CARDWELL. Thank you, Mr. Chairman.

[Whereupon, at 12 p.m., the subcommittee was adjourned, subject to call of the Chair.]

FINANCING THE SOCIAL SECURITY SYSTEM

TUESDAY, JUNE 17, 1975

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The subcommittee met at 1:45 p.m., pursuant to notice in room H-208, the Capitol, Hon. James A. Burke (chairman of the subcommittee) presiding.

Mr. BURKE. The subcommittee will come to order.

The hearings beginning today are a continuation of the hearings on the financing of the social security program which the subcommittee held last month. The subcommittee's earlier hearings were limited to Administration witnesses and invited panelists. Today we will commence general public hearings. These hearings will continue tomorrow and conclude, according to our present schedule, on Thursday.

Without objection, I will have inserted at the conclusion of my statement, the subcommittee's press release of May 28, 1975, announcing this phase of its hearings.

The subcommittee hopes to elicit at these hearings recommendations to improve the financial condition of the social security trust funds. We have requested that particular emphasis be placed on the early-year financing of the program, but we recognize that the issues relating to long-range financing are affected by steps that might be taken on short-range financing. To that degree we are, therefore, prepared to take testimony on general recommendations affecting both the short-range and the long-range.

We will certainly be looking for the administration's full cooperation, and I am enough of an optimist to hope that we will gain their full support for the legislation which—I am convinced—will have to be enacted this year to assure the financial soundness of the social security program.

[The press release follows:]

[Press release of Wednesday, May 28, 1975]

CHAIRMAN JAMES A. BURKE, (D. MASS.) SUBCOMMITTEE ON SOCIAL SECURITY, COMMITTEE ON WAYS AND MEANS, ANNOUNCES SECOND STAGE OF PUBLIC HEARINGS ON FINANCING THE SOCIAL SECURITY SYSTEM

Chairman James A. Burke (D. Mass.), Subcommittee on Social Security of the Committee on Ways and Means, today announced that on Monday, June 16, 1975, the subcommittee would begin holding general public hearings on the subject matter of *financing* the social security program. These hearings are a continuation of the hearings which the subcommittee began holding on May 7, 1975

but which thus far have been limited to Administration witnesses and invited panelists.

The limited subject matter of these hearings should be carefully noted. The purpose of the hearings is to give interested parties an opportunity to express their views concerning the *financing* of the social security program, with particular emphasis on the need to strengthen the short-range financing of the program since it is the intention of the subcommittee to take action on legislation affecting early-year financing (the next 25 years) before considering legislation affecting the long-range financing (the next 75 years) of the social security program. As indicated, these hearings are limited strictly to financing issues and will not cover other matters. For example, expansion of benefits, the categories of beneficiaries, lowering of age limits, and retirement test, etc., will *not* be included.

Under the subcommittee's tentative agenda, the hearings will commence at 1:00 p.m. in the Main Hearing Room of the Committee on Ways and Means in the Longworth House Office Building, on June 16, 1975 and continue at the same hour each day during that week. It is hoped that these hearings can be completed by the end of the week of June 16th. In view of the uncertain schedule of the full committee, however, it may be necessary to reschedule some of these hearings or to change their location to Room H-208 in the Capitol Building.

Due to the limited time available for this hearing, it may be necessary to allocate the amount of time available to each witness for the presentation of his direct oral testimony. If so, it will be mandatory that all witnesses not exceed the time allocated for this purpose. The witnesses' full statements will be included in the record of the hearing.

Cutoff date for requests to be heard.—Requests to be heard must be received by the Committee no later than the *close of business, Thursday, June 5, 1975*. Requests should be addressed to John M. Martin, Jr., Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515, telephone: (202) 225-3625. Notification as to the witness' scheduled date of appearance will be made as promptly as possible after the cutoff date. *Once the witness has been advised of his date of appearance, it is not possible for this date to be changed.* If a witness finds that he cannot appear on that day, he may wish to either substitute another spokesman in his stead or file a written statement for the record of the hearing in lieu of a personal appearance, because under no circumstance will the date of an appearance be changed.

Requests to be heard must contain the following information:

1. The name, full address and capacity in which the witness will appear.
2. A list of persons or organizations the witness represents and in the case of associations and organizations, their address or addresses, their total membership, and where possible a membership list.
3. If a witness wishes to make a statement on his own behalf, he must still nevertheless indicate whether he has any specific clients who have an interest in the subject, or in the alternative, he must indicate that he does not represent any clients having an interest in the subject he will be discussing.
4. A topical outline or summary of the comments and recommendations which the witness proposes to make.

If it is necessary to allocate time to each witness, this amount of time will be strictly adhered to. Witnesses are urged to verbally summarize their statements; the complete statements submitted to the Subcommittee will be included in the printed record of the hearing and will be reviewed and fully considered by the members of the Subcommittee.

It is requested that persons scheduled to appear before the Subcommittee to testify at this hearing submit 30 copies of their prepared statements to the Committee office, Room 1102 Longworth House Office Building, no later than 48 hours prior to their scheduled appearance. An additional 30 copies may be furnished on the date of appearance, for distribution to the press and the interested public. For the quick reference of the Members of the Subcommittee and its staff, the prepared statement should be accompanied by a brief summary of the points covered in the full statement.

Any interested person or organization may, in lieu of a personal appearance, file a written statement for inclusion in the printed record of the hearing. For this purpose, statements should be submitted in triplicate by the close of business, Monday, June 30, 1975. Additional copies may be furnished for distribution to the press and the interested public if submitted during the course of the public hearing.

Pursuant to the Committee rules, for those organizations and individuals who are scheduled to appear and testify, a transcript of their remarks will be available

for correction on the day following their appearance (usually by noon) in the staff office, Room 1102 Longworth House Office Building. The record will be available for such correction for several days after the appearance, as well. If the witness is unable to be present or designate someone to review his remarks, the testimony will be printed as transcribed by the official committee reporter.

Mr. BURKE. Our first witnesses today are Mr. James B. Hallett and Mr. William R. Brown from the Council of State Chambers of Commerce.

Gentlemen, you are recognized.

STATEMENT OF JAMES B. HALLETT, SECOND VICE PRESIDENT, THE TRAVELERS INSURANCE CO., AND MEMBER, SOCIAL LEGISLATION COMMITTEE COUNCIL OF STATE CHAMBERS OF COMMERCE, ACCOMPANIED BY WILLIAM R. BROWN, ASSOCIATE RESEARCH DIRECTOR, COUNCIL OF STATE CHAMBERS OF COMMERCE

Mr. HALLETT. I am James B. Hallett of Hartford, Conn., where I am second vice president of the Travelers Insurance Co. I appear today as a member of the Social Legislation Committee of the Council of the State Chambers of Commerce. Accompanying me is William R. Brown, associate research director for the Council of State Chambers of Commerce. The council consists of 32 State chambers of commerce. Our statement is based on policies generally endorsed and passed in the past.

With your permission, Mr. Chairman, I would like to file our eight-page statement and summarize our views orally in under 5 minutes.

Mr. BURKE. Without objection, the entire statement will appear in the record.

Mr. HALLETT. We want to present our view on short-run 25-year financing of the social security program. We submit three points to you:

One, among the causes for the impeding deficit are the automatic escalation of benefits tied in with the Consumer Price Index and taxable wage base escalators. In 1969 we thought and we still think it is impossible to design workable automatic formulas. There is no substitute for periodic review by the Congress of both benefits and financing.

However, point two, if you do not find it feasible to end the escalator provisions then we feel that the noncontroversial so-called decoupling approach recommended by the advisory council will bring results more stable and consistent in relation to wages.

Point three, we do not believe that you should use general revenues to make up any deficits either short range or long range. Nor do we believe that you should increase taxable wage base to accomplish the making up of deficits.

On the contrary we believe the deficit should be met by a tax rate increase effective not now, but in 1977. Experts who testified before you last month testified that a 1-percent increase, 1½ percent each on employer, and on employee, will meet this deficit for the next decade or so. We think this is a straightforward, realistic approach and follows the precedent set by this committee since the enactment of the social security program itself 40 years ago.

Thank you for your courtesy, Mr. Chairman. I promised to be brief.

[The prepared statement follows:]

STATEMENT OF JAMES B. HALLETT ON BEHALF OF THE COUNCIL OF STATE CHAMBERS OF COMMERCE

SUMMARY

Automatic Escalation.—This Subcommittee should carefully review and see what lessons can be learned from the causes of the current deficit. Adoption of the automatic benefit and taxable wage base escalators greatly contributed to the problem. Logically, the way to solve this problem would be to repeal the automatic benefit and wage base formulas and return to the practice previously followed of periodic review and decision by Congress, not automatic formulas, on benefits and financing of these benefits at the same time. It is recognized, however, that what is "logical" may not be "politically feasible."

Preference for a Rate Increase.—Continuation of the automatic formulas will mean that the wage base will continue to escalate automatically. Therefore, the deficit should be primarily met by a tax rate increase, effective in 1977. Above all, general revenue financing should not be used.

Reasons for Not Increasing Base in Addition to Automatic Escalation.—(1) Inhibition on corporate savings and investment; (2) hinderance to job-providing capital formation; (3) increased cost for hardpressed middle income wage earners; and (4) increased inequity.

Support for Joint Contributory System.—Dangers in General Revenue Financing: (1) Undermines basis for public confidence; (2) violates earned-right and wage-related principles; and (3) would lead to a needs-tested welfare-type program.

STATEMENT

My name is James B. Hallett. I am second vice president of The Travelers Insurance Company, Hartford, Connecticut. I appear today as a member of the Social Legislation Committee of the Council of the State Chambers of Commerce. Accompanying me is William R. Brown, Associate Research Director for the Council of State Chambers of Commerce. Normally, we append a list of State Chambers of Commerce who have specifically endorsed this particular testimony. Time did not permit us to follow our normal procedure. However, this statement is based on policies that the Council's member State Chambers of Commerce have generally endorsed in the past.

AUTOMATIC ESCALATION AS A CAUSE OF FINANCING PROBLEMS

Before making specific recommendations for alleviating the Social Security financing deficit, it is appropriate to briefly consider the causes of the current problem. Social Security Commissioner James B. Cardwell succinctly summarized the problem at a May 5 press briefing as follows:

(1) Since social security benefits are, by law, tied to the Consumer Price Index, higher than previously anticipated levels of inflation in the present economy mean higher than previously anticipated expenditures for social security benefits . . .

(2) Today's decreased levels of employment mean less income to the program through the payroll tax.

The impact of the recession and resulting loss of payroll tax revenue from unemployment is obvious, but hopefully the tax cut stimulus plus the appearance of some encouraging economic indicators will accelerate employment and increase payroll tax revenues.

However, even prior to the economic downturn and the drastic increases in unemployment, the excessive drain on Social Security funds resulting from linking benefit levels to the Consumer Price Index could be anticipated—and was anticipated.

The testimony on May 14 before this Subcommittee by J. W. Van Gorkom, Chairman of the Social Security Advisory Council Subcommittee on Financing, provided an excellent explanation of how the automatic benefit and taxable wage base escalators contributed to the current problem.

Mr. Van Gorkom made the point that the automatic benefit and wage formulas were based on the assumption that wages would continue to rise about twice as

fast as prices, but it is now estimated that over the next 75 years wages will rise at a compounded rate of 6% while prices will increase at a 4% rate, resulting in a deficit of 1.25% for the next 25 years.

In this connection it seems pertinent to recall the testimony in opposition to the automatic escalator proposal made by Paul L. Henkel, Chairman of the Social Security Committee of the Council of State Chambers of Commerce, during his appearance before the House Ways and Means Committee November 5, 1969:

"... The possible dissimilar operation of the two different factors (cost of living and quarterly taxable wages) could distort both the benefit formula and the benefit-wage relationship as well as the program financing. The distortion would not necessarily be equitable to either beneficiaries or taxpayers, and undoubtedly would require the continued program review and adjustment by the Congress."

"The proposal would eliminate from consideration the underlying coverage, demographic and economic factors necessary to determine the actual soundness of the program. It would also eliminate from consideration the general economic climate of the nation as well as the overall burden on our taxpayers."

"We do not think it possible to design an automatic formula to meet our objections or avoid the pitfalls mentioned above. We feel that there is no substitute for periodic Congressional review of benefits and financing at the same time."

This has turned out to be a pretty prophetic warning. Although we endorse the so-called "decoupling" proposal to improve the operation of the automatic benefit escalator, we still do not think that it is possible to design an automatic formula that will work satisfactory—there continues to be no substitute for periodic Congressional review of benefits and financing at the same time.

Ideally the best answer would be to repeal the automatic benefit and taxable base escalators and go back to the old system whereby when Congress increases benefits, it at the same time makes provisions for financing those benefits. It is recognized, however, that politically this will be very difficult to do.

PREFERENCE FOR TAX RATE INCREASE

Assuming that the Subcommittee's decision is to continue to let the taxable wage base increase automatically, first consideration should be given to a tax rate increase to finance the current deficit rather than a base increase over and beyond the automatic escalation or resort to general revenues. We note that two of the Advisory Council members, J. W. Van Gorkom and J. Henry Smith, told this Subcommittee on May 14 that a rate increase in the neighborhood of 1% (one-half of one percent, applying both to the employer and the employee) should suffice for meeting the deficit for the next decade or so.

We also support the position taken by HEW Secretary Weinberger in testimony to this Subcommittee on May 20 on behalf of the Administration that the *effective date* of any tax increase to finance the current deficit should not be before 1977. Already scheduled payroll tax increases will be enough drag on the economic recovery without adding to them.

J. Henry Smith, in his statement to the Subcommittee on May 14, did an excellent job of listing four reasons why increasing the maximum taxable earnings base more than already provided for through the automatic provisions would be very unsatisfactory. We would like to briefly rephrase these reasons with our own emphasis:

1. *Basic layer of protection.*—Perhaps the most important principle involved in maintaining the soundness of the system is adherence to Social Security as a basic layer of protection. Government policies should be aimed towards providing incentives for private savings and pension plans to supplement the basic layer of protection provided by Social Security. Raising the taxable wage higher than provided for under the automatic formula, which it is estimated will produce a \$19,000 base by 1979, will inhibit private savings and investment.

2. *Reduce job-providing capital formation.*—Both Mr. Smith and Mr. Van Gorkom, in their statements to this Subcommittee, emphasized the hindrance to capital formation from wage base increases. Base increases, by eroding private savings and investment, would be a serious deterrent to badly needed job-creating capital formation.

3. *Increased costs concentrated on a small group.*—Relying on wage base increases places the burden on a relatively small group of middle-income wage earners, many of whom are already hardpressed.

4. *Increased inequity.*—Since the benefit schedule is weighted in favor of the low-income beneficiary, an increase in the wage base does not provide a proportional benefit increase and so aggravates what many consider the inequity of the present system. It invites further questions from middle-income groups, especially younger middle-income workers, as to whether or not they could get more for their money by purchasing their own protection.

SUPPORT FOR THE JOINT CONTRIBUTORY TAX SYSTEM

The greater public confidence in the Social Security system is based, we believe, on the joint contributory tax system and the wage-related nature of the benefits. A basic objective of the Congress is, of course, to protect the public confidence in the Social Security system. Therefore, great care should be taken so as not to take "further" action which will undermine that public confidence. We say "further" action because to the extent that Congressional action, such as adoption of automatic benefit and wage formulas, contributed to the current deficit the public confidence in the soundness of the system had to some extent been shaken. This Subcommittee is properly attempting to reassure the public at this time. For these reasons we concur in the testimony that has been given to you by Secretary Weinberger, Commissioner Cardwell, members of the Advisory Council and others that general revenues should not be used to meet the deficit or be relied upon to finance the system.

Use of general revenues would undermine the earned-right and wage-related principles that are an essential part of the basic Social Security program. Extensive use of general revenues would very likely lead to converting Social Security into a "needs-tested-welfare" program.

Mr. Chairman, at this point we would like to enter into the record a compilation of brief quotes by former Social Security Commissioners in support of contributory wage-related tax and benefit system and in opposition to general revenue financing.

OPPOSITION OF SOCIAL SECURITY COMMISSIONERS TO GENERAL PERSONAL FINANCING

President Roosevelt's opposition to general revenue financing and his specific rejection of the recommendation for use of general funds about 1965 have been recorded by the first Social Security Commissioner, Arthur J. Altmeyer, who played a major role in the drafting of the Social Security Act. Mr. Altmeyer in his 1966 book on *The Formative Years of Social Security* (University of Wisconsin Press) gives the following account:

"... the President emphasized in his June 8, 1934 message to the Congress that he favored financing any long-range program through a contributory social insurance system rather than by an increase in general taxation. At a meeting during the early days of the committee, he told Miss Perkins, Dr. Witte, and me that he was opposed to the Townsend plan or any other plan supported by general taxation. However, he recognized the necessity of using general revenues to finance assistance to people already old and without means.

"The President's desire to place chief reliance on a system of contributory social insurance was due as much to his belief that it was a financially safe system as to his belief that it provided protection as a matter of earned right. He felt that requiring the benefits to be financed by contributions furnished a built-in safeguard. (Altmeyer, page 11)

* * * * *

"On the afternoon of January 16, after the President had already notified Congress that on the following day he would present a special message on economic security, he sent for Miss Perkins. He said there must be some mistake in a table which appeared in the report since he had not understood that a large deficit to be met out of general revenues would develop in the old age insurance system beginning in 1965. It is probable his attention had been called to this by the Secretary of the Treasury. When informed that the table was correct, the President said the report must be changed at least to the extent of indicating this plan was only one of several that Congress might consider. He also directed that the committee proceed to develop, as soon as possible, a completely self-sustaining old age insurance system . . ." (Altmeyer, page 29)

Mr. Altmeyer then goes on to record that the Secretary of the Treasury, Henry Morgenthau, Jr., appeared as the last Administration witness before the House Ways and Means Committee considering the original Social Security Bill "... to present the Administration's proposal for a completely self-sustaining old age insurance system which had been agreed upon by the Committee on Economic Security and approved by the President..." (Altmeyer, page 33) The Economic Security Committee actuaries estimated that the tax schedules in this amendment would make the program self-financing at least until 1980. (Witte, Edwin E., *The Development of the Social Security Act*, Madison, 1962, pages 147-151)

Other former Social Security Commissioners have also published books after retiring from this office and have endorsed the contributory system. Thus, Charles I. Schottland wrote:

"CONTRIBUTORY AND WITHOUT GOVERNMENT SUBSIDY

* * * * *

It is interesting that this principle of joint contributions by employer and employee was accepted in the original Social Security Act almost without debate. ... the importance of the principle is that it encourages a responsible attitude on the part of those covered by the system. The taxpayer knows that the benefits for himself and his family are made possible by the payment of social security taxes, and his knowledge gives him a personal interest and stake in the soundness of the program. He realizes also that there is a relationship between the benefits received and the taxes that have been paid; he knows that increased benefits generally require increased taxes." (Charles Schottland, *The Social Security Program in the United States*, Appleton-Century-Crofts, 1963, page 58)

Similarly, former Social Security Commissioner William Lloyd commented as follows:

"The system should be financed by contributions, preferably with those who are protected and their employers jointly paying the bill. Financial integrity is of great importance in a social insurance system. Any public benefit scheme must have build-in protections against the demands of the irresponsible, the charlatan, the demagogue, and the do-gooder. This is accomplished by consistently relating benefits to costs and by making those protected pay the costs of their own protection. Some countries have learned this bitter lesson through painful experience. Succumbing to demands for higher benefits with inadequate financing may have disastrous consequences." (William Lloyd Mitchell, *Social Security in America*, Robert B. Luce, Inc., 1964)

CONCLUSION

In conclusion, we believe that this Subcommittee should carefully review and see what lessons can be learned from the causes of the current deficit. We believe that adoption of the automatic benefit and taxable wage base escalators greatly contributed to the problem. Logically, the way to solve this problem would be to repeal the automatic benefit and wage base formulas and return to the practice previously followed of periodic review and decision by Congress, not automatic formulas, on benefits and financing of these benefits at the same time. We recognize, however, that what is "logical" may not be "politically feasible."

Continuation of the automatic formulas will mean that the wage base will continue to escalate automatically. Therefore, the deficit should not be met by a base increase, but by a tax rate increase, effective in 1977. Above all, general revenue financing should not be used.

Mr. BURKE. Does the other gentleman wish to say something?

Mr. BROWN. No; I am simply here in case you want to interrogate. I will be glad to assist in responses.

Mr. BURKE. Are there any questions? Mr. Archer.

Mr. ARCHER. I think you succinctly stated your comments and recommendations. I don't believe I have any questions with respect to it.

Mr. CONABLE. You gentlemen are aware one of the reasons the escalation was added, are you not—there is some feeling that Congress

was going far beyond—because of the political attractiveness of increasing benefits—going far beyond the increase in the cost of living.

There was some feeling therefore by many people concerned about the direction of social security that the existence of such an escalator would take pressure off the political attractiveness of an increase frequently repeated by Congress largely in many cases without consideration as a result of nongermane amendments put on by the Senate.

I realize that this came on top of some benefit increases which were difficult to justify from an actuarial viewpoint and therefore further exacerbated the problem, but I want you to understand the historical reasons for our having gone to escalation rather than continuing on an annual basis to given benefit increases in excess of the cost of living.

Do you think that SSI is a potential device for taking pressure off this constant pumping up of the social security system and have you considered the options that that particular device makes available to us to get money to the really poor among the elderly rather than having to put, let's say, \$6 billion into the system to get \$1 billion to those who are really poor?

Mr. HALLETT. I think, sir, that I have got to go back to the classic fundamentals in which I was raised in first listening to appearances before this committee in June of 1948. This is my 27th year sitting in the background. Now, I have a chance to talk.

Congress has to decide which is the welfare needs approach and which is the basic wage-related program. We have consistently argued, keep wage related what is wage related and keep welfare and general revenues what is welfare. I believe that as long as that balance is maintained that the thing can proceed.

You have to pay taxes to get the benefits. I am impressed by the fact that my generation, I am told, is the last generation to have a chance—if I live out my life expectancy—of profiting from the social security benefit system. I will be the only one—my generation will be the last to get out more than we put in if we live out our expectancy.

My son who is 31 can never get it back. I think this balance is very important. Remember, I am not neither actuary or economist and I could not explain to you decoupling. I would have to refer you to page 139 of the Advisory Council report, but our theory is to keep intact for public confidence and for the basic theories of the system the wage-related aspects.

Now, I admit that medicare was never wage related. Someday in the distant future if we get a proper competitive national health insurance bill, perhaps medicare will be taken away from the wage-related aspects. Perhaps this will be a combination of private enterprise and general revenues. We do not advocate that at this time.

Mr. BURKE. Mr. Mikva.

Mr. MIKVA. Neither was the minimum rate a wage-related thing either. We did that a long time ago. You were probably sitting in the room when that happened. Do you really think that is the touchstone of what is wrong with the system—that people are not going to get back as much as they put in—that the wage-related theory, which had lots of opponents at the time it was first adopted, no longer flies?

Mr. HALLETT. No; I think it is very viable and should be kept flying. You have to have minimums, otherwise you are going to have to take care of people through public assistance on the basis of how much people willing to work are willing to pay for those who won't and can't. The social security system has been set up to take that over as a base, as you know, on which private enterprise—the company for which I work and others—can provide pensions on top with the public assistance program on the other side on the basis of need.

Mr. MIKVA. Let me pursue this further. I think I understand our agreements and our disagreements but you touch on the root of many things that we are going to have to think about and do, and it troubles me that there is almost an oversimplistic statement about what is wrong with the system, that is that there is no longer this direct immediate relationship between wages and between taxes paid and benefits at the end. I think the problems of the system are far more complicated than that and that maybe is not even a problem.

For example, how would you react to a tax base which said that all earned income should be taxed at a much lower rate?

Mr. HALLETT. For social security purposes or income?

Mr. MIKVA. Social security purposes.

Mr. HALLETT. A very broad tax base, lower rate. I think the basic theory was that you try to keep that as near to the average manufacturing or nonmanufacturing wage in the country which is now between 8 and 9 and now we are up to \$14,100 on the taxable wage base and someone told me by 1980 it is expected to go to \$19,000.

Mr. MIKVA. We already passed that theoretical thing some years ago so maybe that would be a good solution to our financing problem.

Mr. HALLETT. It might be. I would have no thoughts until I go back to my people.

Mr. MIKVA. But it ought not be something we should reject out of hand because it does not relate to the benefit.

Mr. HALLETT. I agree.

Mr. BROWN. If I might just add, Mr. Mikva, I think probably our committee would have considerable problem with going to the full wage.

Mr. MIKVA. I think you would, too.

Mr. BROWN. When you get to the corporate payroll tax people that make up our committee this would be something that I think they would take strong exception to and probably—I better get it into the record—that very likely would be the case.

Mr. MIKVA. Let me assure you I am a lawyer and my profession would have strong comments.

Mr. BROWN. If I might get back to the other point you were making, we were not trying to place the blame for the present deficit problems on the lack of related benefits to wages. That came about because of Mr. Conable's very excellent question that you can take some of the pressure off the program by going to welfare programs to handle welfare programs and social security to handle wage-related programs. We agree with that position.

Actually the main point that we point to that was a cause of the problem was the reliance on the automatic escalators which did not work out as projected. Wages and the cost of living didn't increase in the proportions it was projected.

Mr. MIKVA. Except Mr. Conable explained the purpose for doing that was then salutary and still is.

Mr. BROWN. This shows the bipartisan nature of our position, you see, because it was a Republican administration proposing that. We did not accept it at the time. We recognize it is a valid argument. But we did not think it would actually work out that way.

Mr. MIKVA. On the other hand, you have no idea what kind of increase might have been voted by this Democratic Congress, for example, but for that escalator clause.

Mr. BROWN. You did vote increases without letting the escalator go into effect, you see.

Mr. HALLETT. Mr. Chairman, may I mention another thing that impressed me very much in the report of the advisory council on social security. A figure that has probably been brought to your attention many times.

Right now there are 100 people working to take care of 30 people on OASDI and very, very soon there will only be two to one and there is even a recommendation in there that you increase the retirement age for that purpose up to 67, 68.

Mr. MIKVA. You notice there was a rush of sponsors for that bill.

Mr. BURKE. I would just like to ask you one question on this recommendation of yours to finance the short term deficit through, an increase of the 1-percent tax—half a percent on the employer, half a percent on the employee. That will raise approximately \$6 billion in 1977. The information I have, is that they expect a \$15 billion deficit between now and the time of enactment. So if you only raise \$6 billion what do you want to do about that \$9 billion deficit for 1977?

Mr. HALLETT. I can't answer you, Mr. Chairman, other than to say one of my oracles and prophets is Mr. J. Henry Smith who was on the advisory committee and testified before you on May 14 and it was his computation that this was the way to handle this particular problem, a 1-percent increase to offset expected deficits over the next 10 to 15 years and to replenish the social security trust fund to some extent. But I will try to get back to you if you want an answer to your question.

[Additional material follows:]

With respect to short run (25 year) financing of the social security program, we urged that the prospective deficit be met by so-called "decoupling" as recommended by the 1975 Advisory Council Reports (pp. 129-135) plus a 1% rate increase (1/2 on employer; 1/2 on employee) effective in 1977.

You stated that this would raise approximately \$6 billion in 1977; but that "... they expect a \$15 billion deficit and also a loss of about \$2 billion in interest between now and the time of enactment which would make that \$17 billion, so if you only raise \$6 billion, what do you want to do about that \$9 billion deficit for 1977? . . ."

The Trustee's 1975 Annual Report (Table 15, page 47) estimated OASDI deficits (in millions) as follows

Year:	
1975	\$2, 977
1976	5, 789
1977	5, 776
Total	14, 542

Our answer to the question is the same as that given by Secretary Weinberger in behalf of the Administration—that is until the tax increase becomes effective in 1977, it would be necessary to draw on the reserve fund. As Secretary Weinberger indicated, the basic purpose of the reserve fund is to meet this type of emergency situation.

Mr. BURKE. You don't have to refer to Mr. Smith. Just refer to your own commonsense. The loss of \$9 billion—it does not seem to me to be a very prudent thing to be doing.

Mr. BROWN. Mr. Chairman, if I might just add there, we are not necessarily wedded to the precise figure. That may not be the correct figure. It may take more than that. We believe that would be the correct approach assuming that you are going to continue to let the base escalate. Then you ought to look to the rate to make up the deficit that the base is not taking care of. Of course, if you are not going to let the base escalate then it is logical to have a rate and a base increase as you have done in the past.

Mr. BURKE. I think our problem is a lot more serious than what has been spelled out here. Your testimony is almost the same as Secretary Weinberger and I expressed deep concern about this. We keep postponing the inevitable until after November 1976, and I don't have to tell you what takes place in that month.

Mr. BROWN. We are not suggesting you should wait until then to decide what you want to do.

Mr. BURKE. I have been trying to tally up all the problems that this Government is going to face in January of 1977. And I imagine your organization is concerned about this. If we have a \$15 billion deficit here and if they have a bill out there on the floor to increase the debt ceiling by another \$69 billion, I can see a new President coming in in January of 1977 having to recommend an additional tax of \$100 billion.

Mr. JACOBS. Technical inquiry, Mr. Chairman.

You say there will be a new President. A lot of my friends have been wondering about that.

Mr. BURKE. The President who takes his oath of office in January. I don't want to make any predictions.

I am wondering whether or not we can continue to postpone what is so clear in front of us.

There is an expression around here, "bite the bullet" and they won't even bite a marshmallow. I am a little surprised at your organization and a little disappointed that you have not come in here with some stronger recommendation.

Mr. STEIGER. There are pretty strong recommendations I thought in opposition to your bill.

Mr. BURKE. What bill?

Mr. STEIGER. The one that provides one-third funny money out of the general fund and one-third out of the taxes and one-third out of some other area.

Mr. BURKE. That bill is not being heard here.

Mr. STEIGER. I am sorry.

Mr. BURKE. Until I get 219 signatures on it I don't think we should get into any serious discussion of it. What we are involved here with is new financing. That is what we are trying to deal with.

Mr. CONABLE. I would like to thank the chairman for his modesty. Don't you think we should pass it before we have any serious discussion of it? You are saying only until you get 211 signatures. Until you get that you are not going to have any serious discussion of it. I wonder if it would not by extension be even a better democratic process to pass it first and then discuss it.

Mr. BURKE. If you are going to sidetrack a problem here, we can get into a political discussion if you want to. But I am trying to find some answers here to this deficit that we face in 1977 and find somebody around with a little bit of courage, just a little bit, somebody with a little bit of courage to come in here and make a little bit of a recommendation.

The recommendation of this organization will raise \$6 billion and leave a \$9 billion deficit for 1977, and I don't think that that is a very sound recommendation.

Mr. ARCHER. I think the time for you to pose that problem was to Mr. Smith when he was here making that recommendation. If I recall, that was not posed at that time.

Mr. BURKE. More than likely I should have but I thought I would take it up with this gentleman because he seems so well informed.

Mr. HALLETT. I will get back to you on the figures.

Mr. BURKE. If you can supplement your statement here today and give us an additional recommendation.

Mr. MIKVA. If the chairman would yield, with all deference to my friend, Mr. Archer, they did say they concurred in that position as I understand the statement. And that is why I think it is relevant and why I think the chairman's question is relevant.

Mr. ARCHER. Was the gentleman from Illinois here when Mr. Smith presented his testimony?

Mr. MIKVA. No, but I read it and I heard about it.

Mr. ARCHER. There was no refutation at that time that their proposal for solving the short-range problem was not adequate to meet the amount of money that is required.

Mr. MIKVA. I understand that. All I am saying is I think the chairman's questions here are relevant because the witness has stated they concur in that position.

Mr. BURKE. We should call Mr. Smith in to tell us what he wants to do about the \$9 billion deficit.

Mr. BROWN. Mr. Chairman, if I might add, I think the position of our committee basically would be we would support a rate increase that is adequate to make up the deficit. We would be concerned, as the administration is, about making it effective immediately because of the effect on economic recovery. Payroll taxes are going to be going up greatly anyhow, not only in the social security area because of the escalating base but the payroll taxes for unemployment compensation will be jumping greatly as a result of State experience rating systems. This is a cost that can deter employers from employing people, giving them jobs and creating income.

We are in a period of needing to work toward economic recovery so we are concerned about the timing—we are ready to support a rate increase that would be adequate to take care of the deficit.

Mr. HALLETT. Our hopes are that the general revenue approach not be used to make up the deficit.

Mr. BURKE. I can appreciate your feeling on that.

Mr. WAGGONER. Mr. Chairman, just one question. When you say you will support a rate increase to satisfy the deficit, did you purposely exclude a tax base increase?

Mr. HALLETT. We would prefer to, since the tax base is going up anyway automatically. Until such time as we get control of inflation we would prefer that the tax base not be raised for that purpose.

Mr. WAGGONNER. A follow-on question. On the same basis that the taxable base is scheduled over a period of time to increase, there is a corresponding rate increase too?

Mr. HALLETT. Yes, sir.

Mr. WAGGONNER. So the only point I am making is you specifically mean a tax-rate increase and not a base increase?

Mr. BROWN. That is right, on the assumption the base will continue to automatically escalate. If you move away from that then we would see a combination of two as being reasonable.

Mr. WAGGONNER. That is all I have.

Mr. BURKE. Are there any further questions?

Mr. JACOBS. Sir, you asserted your opposition to the removing qualification of the wage base, but I don't believe you said exactly why. That is to say what is your specific objection?

Mr. HALLETT. I am not sure I understand your question. Objection to general use of revenues?

Mr. JACOBS. I didn't say that. As I understand it you believe in orderly annexation of additional wage base rate.

Mr. HALLETT. As close to the national levels as is possible.

Mr. JACOBS. What is your objection to applying either a flat or progressive rate specifically for a social security trust on all income.

Mr. HALLETT. On unearned income?

Mr. JACOBS. Well, say all earned income.

Mr. HALLETT. All earned income. You mean the other gentleman's question of go clear to the top?

Mr. JACOBS. Yes. I know your opposition, but I did not hear your rationale.

Mr. HALLETT. That does not bother me a bit except it violates the 40-year-old concept of keeping it as near the national level as is possible. But theoretically otherwise if you have to get so much money up you may have to go to that.

Mr. BROWN. I think you have a problem of being careful not to undermine our basic social insurance concepts that are involved here. The wage related concept is the basic concept.

Mr. JACOBS. Why do we have a problem of not undermining our basic social insurance concept? Why is that a problem?

Mr. BROWN. The great public confidence in the social security system is based on their belief that this is a wage related program.

Mr. JACOBS. Do you think anybody is stupid enough to believe now what they are paying into goes into an annuity account?

Mr. BROWN. No. Put quotes around the "social" of social insurance. Social insurance is something entirely different than the type of insurance that Mr. Hallett's company sells.

Mr. JACOBS. You think most of the people don't understand that difference and they are still fooled a little by calling it some kind of insurance. Is that it? They are inspired by the use of the term; is that it?

Mr. BROWN. I think the fact that the employee is paying in during his lifetime—he knows the benefits he is going to receive are related in some manner, admittedly not perfectly but in some manner to the amount he pays in.

Now, if you are going to make it the entire taxable payroll, are you going to give the chairman of the board benefits in proportion to the—

Mr. JACOBS. That is a very interesting thing. As I understand it in most of the western industrialized democracies it is done precisely thus; is it not?

Mr. BROWN. I don't know.

Mr. JACOBS. Let me be the first to tell you I have read from a number of sources that it is.

Mr. BROWN. I think the social security actuaries could have some problem with that type of thing. I think the public would have some problems with that because it would be such a drastic change from what they have come to accept as our social insurance system.

Mr. JACOBS. Point No. 2. The aspect of the insurance of social security can possibly be considered, can it not, as the insurance against bad luck in old age. I, who happen to be blessed with some property, I think I am secure without social security or even without a retirement program but something could go wrong with that along the line and maybe I don't object to paying my taxes toward the social security program because if bad luck befalls me and my investments go sour I would not have to die. Wouldn't I feel as though I had participated in the insurance against that unfortunate investment if I made my contribution?

Mr. BROWN. Maybe the chairman of the board could look at it that way but I don't think Congress wants to design the social security system from that viewpoint. I think you all want to design it from the viewpoint of the average worker. I think from that viewpoint, the concept that is most important is a basic layer of protection that he starts with and then builds on it with any private sources or investments that he may have—that is a proper concept.

Mr. JACOBS. Mr. Chairman, for longer than I can remember I have paid for health insurance. I believe it is correct to say that I have never collected a penny in benefits from that health insurance. I believe that is correct to say so far. I am lucky. I lost all my premiums and I am still lucky and that is my very point. That if everybody in this country contributed to the social security program, they would be lucky if they never collected.

Mr. BROWN. I see your point. I just don't think it jibes with the common public perception of social security.

Mr. JACOBS. Putting it another simpler way. I am a single person. However, I am paying taxes for Ab Mikva's children. Is this fair? Of course it is fair.

Mr. MIKVA. For my children, sure it is fair.

Mr. JACOBS. After all, when they have a handicap of Mikva as a father, they need all the help they can get.

Mr. MIKVA. If my colleague would yield I think we are engaging in, whether you like it or not, what is going to be a bottom of a lot of argument in this subcommittee, but I think you are wrong on one premise and I think we are going to have to figure out some way of finding out just what is the American conception of social security.

I think the average American worker is shocked to know that he pays a higher percentage of his income as social security tax than does somebody in the higher brackets. I think he is shocked to know that. Most of them don't know. When I found that dichotomy—I forget the numbers—but for a while last year somebody earning \$14,000 a year paid a higher percentage of his income overall as taxes than somebody

earning \$19,000 a year—when I tried that on some of my middle income audiences who were earning \$14,000 they were ready to march on Washington.

Mr. HALLETT. To get away from that, Congressman, that analogy, you are going to put private pensions out of business if you go the whole hog of the other route taxing right up to the full earned income or even unearned income and try to put it through the pension system.

Mr. MIKVA. No, because unlike my colleague from Indiana, I would still have a ceiling on how much they would get.

Mr. BROWN. You would get away from the wage related aspect then. That was the question I was raising.

Mr. MIKVA. As you agreed at the beginning of that question that I asked, we left the wage related concept a long time ago. The only question is now how much further away from it will we get or do we still want to think about it or is this fiction somehow important to maintain. You say it is important to maintain because the American people believe it. I am saying the American people do not understand anywhere near what the impact of it is. They do not know that they are paying a higher percentage of their income to support the social security system than somebody who is luckier.

Mr. WAGGONNER. They are getting a higher percentage of return in relation to the higher income people.

Mr. MIKVA. Because they are not as lucky.

Mr. WAGGONNER. They are more fortunate in that instance. Their benefits are relatively higher.

Mr. MIKVA. But they need it more.

Mr. WAGGONNER. Page 3. The last paragraph: Ideally the best answer would be to repeal the automatic benefits and tax base escalator and go back to the old system. What if Congress increased benefits at the same time and makes provision for financing those benefits? Now, have you done anything in the way of study or computer models that you can tell us about that would reflect the situation with regard to social security stability if we had maintained control over the Congress and not had an automatic benefit, or one of the other bases? I take the position—and maybe I am wrong—but it seems to me Congress had aggravated what maybe could have worked. At least the automatic benefit increase is more preferable than political action on the part of Congress because I think there is at least some rhyme or reason to Consumer Price Index increase although I think we aggravated it by not letting it go into effect and providing far in excess, over a period of some transition years, benefits far in excess of what Consumer Price Indexes were.

Have you done any studies which would reflect that?

Mr. HALLETT. We have not. We will search.

Mr. WAGGONNER. Let me ask you another question. You take the position that the automatic benefits can't really be made to work. That is what people are saying about times of inflation. Your payouts are out of proportion. But is it possible to provide, along with cost of living increases based upon the CPI, that automatically there be a financing provision as well that goes hand in hand with it?

Mr. HALLETT. Basically we think it can't be devised.

Mr. BROWN. We will agree, Mr. Waggonner, you need to deal with the two things together. The benefits and financing need to be con-

sidered together. You can't let the benefits go up and then find out you don't have the financing to take care of it.

Mr. WAGGONER. The problem is simply this: We are providing benefits now, as we have in the past which are not financed. We will continue to do so, unless we make some changes in the future to finance whatever we do provide in the way of benefits. Therefore, the problem becomes one of finding a way, if we are going to have automatic increases, to have automatic financing provisions pay the cost of those increased benefits.

Now, that is what we need to find a way to do. Am I right or wrong?

Mr. HALLETT. I think you are dead right. It has to be paid for some time. This is supposed to be a pay-1 in and pay-1 out system.

Mr. WAGGONER. Could I ask you, the company you are with, to see if you could produce something that might be workable for us just to look at.

Mr. HALLETT. Yes, sir, I will do my best, Mr. Chairman.

Mr. BURKE. Thank you, Mr. Hallett and Mr. Brown for your contribution here.

Our next witness is Mr. Isaac Fine, American Association of Retired Persons and National Retired Teachers Associations.

STATEMENT OF ISAAC FINE, AMERICAN ASSOCIATION OF RETIRED PERSONS AND NATIONAL RETIRED TEACHERS ASSOCIATIONS, ACCOMPANIED BY PETE HUGHES, ASSISTANT LEGISLATIVE COUNSEL, AND JAMES M. HACKING, LEGISLATIVE STAFF, WASHINGTON NATIONAL OFFICE

Mr. FINE. Congressman Burke and members of the committee, I am chairman of the Massachusetts NRTA and ART State Legislative Committee. I am here today representing our national organization with well over 8 million members.

On my right is Peter Hughes, the assistant legislative counsel and on my left is James M. Hacking, a member of the legislative staff at our national office here in Washington.

I have had firsthand contact with many retired persons that have traveled the State of Massachusetts and I can tell you that there is actual distress among them because of the scare articles which appear in magazines, otherwise reputable magazines, speaking as if the entire system is about to collapse. They have learned that for the first time in the history of this system we are experiencing, we are going to experience a \$3 billion deficit in the recession in 1975.

Incidentally, I will read part of this presentation and speak orally on other parts.

Mr. BURKE. Without objection, your entire statement will appear in the record.

You may proceed.

Mr. FINE. We also have a summary. To allay the anxiety of the elderly we urge this subcommittee and Congress to enact legislation this year to deal with the short-term deficit. Now, we believe that the short-term deficit is a result of an unhappy conjunction of an intolerable high rate of inflation and a high rate of unemployment and an energy crisis. I think that in our entire history we have not had such a combination of unfortunate economic conditions. The modest

reduction in the inflation rate which we are now witnessing through the use of restricted monetary and fiscal policy has come at an unemployment rate in the last output cost that is simply staggering.

We hope that this subcommittee considering the appropriateness and desirability of various remedies will weigh heavily the probable economic consequences of those remedies and not be diverted from doing so by arguments that the system has historically been "self-financed" and "contributory" and that remedies which do not conform with traditional principles should not therefore be considered.

In other words, we are saying that we are confronted by an unprecedented set of circumstances, an unprecedented situation, and we should think in terms of unprecedented remedies.

Now, the character of this inflation is unemployment. In last year's record inflation was largely the result of the surging energy prices and the power possessed by some concentrated industries to command excessive price increases even while the demand for their products and services were falling.

To rely as the administration did on monetary and fiscal policy to break inflationary pricing practices in these markets is necessary to drive unemployment to extraordinarily and politically unacceptable levels.

The modest reduction in the rate of inflation has occurred at a substantial cost. The longer we refuse to develop any effective policy to deal with administrative pricing practices and permit concentrated industries large and continuing profits which are unjustified on the basis of production cost fair rates of return, the longer will the social security system and its beneficiaries be victimized.

In other words, we are talking about administered prices in a time of high unemployment, high administrative prices. Now, we would like to consider five options. We are against to a large extent the first four and our emphasis is on the fifth option which I will refer to.

The first option is the arbitrary limitation on benefit adjustments under the escalator. You all heard the expression that inflation is the cruelest tax of all. The elderly are particularly vulnerable to this cruel tax. Because with their limited income they spend a disproportionate amount of their income on food, homes, and on medical care. And these items which have risen precipitously more rapidly than the average cost of living has risen. So the inflation has borne particularly severely on the elderly.

Incidentally, with regard to health care it is estimated the elderly spend twice as much in out-of-pocket expenditures as do other segments of the population and while comprising 10 percent of the population they account for 25 percent of prescription drugs. This because the younger people are subject to acute illnesses which they get over rapidly but the aged are subject to chronic illnesses which stay with them for the rest of their lives and which are very expensive.

I would also like to point out with regard to the cost-of-living adjustment, as it is presently constituted, there will be actually a 27-month gap from the time that the process starts to the time that it finishes. There is a 15-month gap to cover the 12 months during which inflation rose and then there is a quarter which lapses prior to the adjustment starting and the adjustment goes over a 12-month period so it takes 27 months from the beginning of the inflationary

period to the time that the adjustment is made. In the meantime inflation is still continuing rampant.

I might point out that under the Federal program both active and retired employees get a cost-of-living adjustment whenever the cost of living rises 3 percent for a period of 3 months or more and a 1 percent in addition to make up for the lag. And this might happen several times in the year in contrast to our mechanism which will involve a 27-month lag.

The employed people have various alternatives to cope with inflation. For instance, an employed person if he belongs to an organization can engage in collective bargaining. He can seek upward mobility through raising his skills, through sharpening his skills. All this is denied to the older person. The only thing the older person can do is rely now on his social security because it is virtually impossible in today's labor market for an older person to obtain employment. So he has no alternative but to look for social security for his necessities of life.

We are very happy with the fact that Congress has shown a very strong opposition to the suggestion from the administration that the cost-of-living adjustment be capped.

Now, the second option is an increase in the payroll and self-employment tax rates. We are against an increase in the payroll tax because to begin with it is a regressive tax. As a matter of fact, so far as most of the older people are concerned it is actually an oppressive tax.

Furthermore, students of this subject are generally agreed that the incidence of the employer's part of the tax falls on the worker as a wage earner, or as a consumer. The employer simply transmits the dollars and cents but the incidence of the tax is on the worker.

We would not, however, oppose an increase in the self-employment tax. We believe that it should be 75 percent of the tax on the employee and that would raise their tax from 7 percent to 7.425. We believe if the tax were raised that it would further impair real disposable income which declined by 3 percent last year.

The third option is legislative increases in the social security contribution benefit base. Now, we recognize that the increase in the base would make the social security tax structure less regressive but we do not believe that this method should be relied upon as a sole method of eliminating the deficit. We would go along—we believe in gradualism—we would go along to an increase somewhat beyond the increase which is automatic, I think which will bring it to 16.4. We would go along with an increase to that.

The advisory committee considered an increase in the base to \$24,000 but rejected it on the grounds that raising a limit would cause social security to interfere with private savings and capital formation.

The next option is the advisory council's proposal to use central revenues to finance the hospital insurance program. Now, here we do not support the advisory council's recommendation that medicare should ultimately be financed solely from general revenues. Our association supports the use of general revenues for an expanded and consolidated medicare and medicaid program and to this end we have developed a competitive Medical Reform Act, Senate 1456, which was introduced by Senator Ribicoff.

Now, we finally come to the fifth option and this is the one which we emphasize which we wholeheartedly support and that is for the limited use of general revenue in the cash benefit program.

In other words, we endorse in principle the use of general revenue funds to finance the short-term deficit which is being experienced by social security—this is a positive position—in contrast to the other four options which I stated.

We urge upon this subcommittee our proposal to finance cost-of-living cash benefit adjustments to the extent that they exceed 3 percent per year out of general revenues beginning in 1976.

Now, why do we support this? Inflation, of course, is a highly complex and controversial subject. It is international. We feel the responsibility can be placed somewhere. If party A injures party B, should party B be responsible for paying the price or should it be party A?

We lay the inflation at the door of the administration and we therefore feel that instead of the elderly, as Congressman Burke said, biting the bullet rather than chewing on marshmallows, we feel that the administration has a responsibility to meet the cost of inflation above 3 percent. It is their responsibility and they should pay. I daresay the social security system per se is not inflationary. It is based on a current cost method.

If anything, the social security system over the years has stabilized prices. Witness the \$45 billion recession that has been built up so you cannot lay inflation at the doorstep of the social security system. Just the opposite. There is only one place you can put it and that is the door of the Government which has failed to control those who administer prices.

We would be willing to support legislation that combines our proposal with a modest legislative increase in the contribution benefit base effective in 1977 to provide the additional revenue needed to eliminate the short-term deficit.

We contend that if the cost-of-living adjustment is either capped or reduced what will happen then is that large numbers of the elderly will actually be driven to seek means, tested public assistance.

This concludes my remarks, Congressman Burke, and if there are any questions we would be pleased to try to answer them.

[The prepared statement follows:]

STATEMENT OF THE NATIONAL RETIRED TEACHERS ASSOCIATION AND THE AMERICAN ASSOCIATION OF RETIRED PERSONS

Mr. Chairman, I am Isaac Fine, Chairman of the Massachusetts Joint State Legislative Committee of the National Retired Teachers Association and the American Association of Retired Persons. These affiliated organizations have a combined membership in excess of 8 million older Americans.

With me this afternoon are Cyril F. Brickfield, Counsel to the Associations, Peter W. Hughes, Assistant Legislative Counsel, and James M. Hacking, a member of the legislative staff.

The overwhelming majority of our members are beneficiaries of the OASDHI programs that constitute the social security system. Having such a major interest in its continued soundness, they are increasingly concerned over the long-term and especially the short-term financial imbalances recently disclosed in the 1975 reports of the Advisory Council and the OASDI Trustees.

In view of the degree to which so many millions of our members are dependent upon the system for income support and health care protection, they cannot but be anxious over the continuation of benefit payments by the system when they

hear that benefit expenditures will, for the first time, exceed revenues by \$3 billion in 1975 and that, in the absence of additional financing, the cash benefit trust fund reserves will be exhausted shortly after 1980. To allay their anxiety, we are here to urge upon this Subcommittee and upon the Congress the enactment of legislation this year to deal with the short-term deficit even though the effective dates of the remedies contained therein may be postponed for economic reasons.

Since the Subcommittee intends to act through separate legislation at a later date upon the related problems of future benefit computation and long-term financing, we shall confine our remarks largely to the short-term problem. Since our members are retirees, it is this problem which is of primary importance to them.

Let it be understood at the outset—the short-term deficit is the direct result of the conjunction of the intolerably high rates of inflation and unemployment that began last year and is expected to continue for the foreseeable future.¹

The modest reduction in the inflation rate that has been achieved (from 12% last year to 6–8% this year) through the use of constructive monetary and fiscal policy, has come at an unemployment and lost-output cost that is simply staggering.

Since inflation and unemployment factors have had and will continue to have a decisive impact on the financial soundness of social security, the system must be considered in the context of the economy in which it exists. We hope that this Subcommittee, in considering the appropriateness and desirability of the various remedies (or combinations thereof) for the short-term deficit, will weigh heavily the probable economic consequences of those remedies and not be diverted from doing so by arguments that the system has historically been “self-financed” and “contributory” and that remedies which do not conform with traditional principles should not therefore be considered.

The system is not cost-indexed and is sensitive to inflation and unemployment. We just had a record inflation. Workers suffered a serious decline in purchasing power. Nine million people are out of work. Circumstances have changed and all the rhetoric in the world about adherence to traditional principles cannot change that.

I. FROM THE 1973 TO THE 1975 REPORTS OF THE OASDI TRUSTEES

The 1973 OASDI Trustees' Report, issued subsequent to the enactment of the preceding year's automatic cost-of-living adjustment amendments, projected an imbalance of only .5 percent of taxable payroll over the '75 period for which estimates are customarily made. This was a relatively minor imbalance and was not considered a cause for concern.

The 1974 report projected a long-range actuarial imbalance of 2.98 percent of taxable payroll as a consequence of lower birth rate projections. The report also contained a sensitivity test² in the appendix which foreshadowed a possible aggravation of the long-term problem because of the manner in which the cash benefit programs were indexed. A 1 percent increase in the long-range annual rate of inflation (from 3 to 4 percent) could increase the average cost of the system by 47 percent.

Using demographic and economic projections slightly more pessimistic than those used by the 1974 OASDI Trustees, a subsequent report by an independent panel³ found a long-term deficit of 6 percent of taxable payroll.

The Social Security Advisory Council, which filed its report⁴ in March, confirmed the long-range problem and, on the basis of new data, identified a short-term financing problem as well. The short-term deficit was found to be the result of unexpectedly high inflation and unemployment rates; the long-term deficit was found to be the result of a combination of low fertility rates and the manner in which the system is cost-indexed under present law.

While suggesting that a long-term problem could be lessened, if not eliminated, by decoupling the indexing of future retirees' wage records from the indexing of benefit amounts for those already retired, the Council acknowledged that the short-term deficit requires immediate additional financing.

The 1975 Report of the OASDI Trustees⁵ reaffirmed the Advisory Council's findings of both the short and long-term deficit problems of the cash benefit pro-

¹ See Table I in the Appendix A, p. 20.

² See Table II in the Appendix A, pg. 21.

³ Panel on Social Security Financing, Report to the Committee on Finance, 94th Cong., 1st Sess. (February, 1975).

⁴ Advisory Council on Social Security, Quadrennial Report, H. Doc. No. 75, 94th Cong., 1st Sess. (1975) (hereinafter referred to as Advisory Council Rept.).

⁵ Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds, 1975 Annual Report (May 1975).

grams. Based on its revised assumptions,⁶ the Trustees indicated that expenditures will exceed revenues in each fiscal year during the period 1976 through 1979 because of the combination of unexpectedly high inflation and unemployment. They concluded that unless additional revenue were provided for the system, the trust funds would be exhausted shortly after 1980.

Having adopted demographic and economic assumptions similar to those used by the special panel (6 percent per annum in average covered wages and 4 percent per annum in the CPI) for the purpose of projecting expenditures and revenues over the customary 75-year period (1974 to 2048), the Trustees found the OASDI system to be substantially under-financed. They concluded that over the remainder of this century, the OASDI system will need additional financing equivalent to 1.3 percent of taxable payroll and significantly higher additional financing after the year 2000. However, the additional financing needs after the turn of the century are largely the result of the automatic adjustment provisions of present law and could be reduced or eliminated by adopting the Advisory Council's recommendation for a decoupled system.

II. THE CHARACTER OF RECENT INFLATION

That the OASDI cash benefit programs require immediate additional financing is solely the result of inflation and unemployment rates higher than anticipated. Persons who are unemployed are not paying social security taxes. High rates of inflation trigger automatic benefit increases which, in turn, must be financed from a diminished number of active workers. This situation is unlikely to change very soon. The OASDI Trustees are predicting an increase in the CPI this year of 9 percent and an average unemployment rate of 8.8 percent. Worse still, they project that this situation will only gradually improve and that even as late as 1980 we can expect a CPI increase of 4 percent and an average unemployment rate of 4.8 percent.

In view of these dismal projections, it would be well to discuss briefly our Associations' view of the type of inflation experienced last year (and likely to be experienced in the near future). Despite the Administration's claims to the contrary, we state emphatically, that it was not the type that results from excess government and consumer spending ("demand-pull" inflation), the appropriate remedies for which would be restrictive monetary and fiscal policy. When real disposable income (the broadest measure of purchasing power) declines 3 percent,⁷ when the automobile industry has its worst sales record for any model year in a decade but raises its prices faster than ever,⁸ and when, for the first time, energy consumption falls, there is no way we can believe that recent inflation was the result of excess demand. While we have had that type before and could have it again if the economy is overly stimulated, it is not what we have had and are having.

Last year's record 12 percent inflation was largely the result of the power possessed by some basic and concentrated industries (oil, gas, steel, automobiles, chemicals, etc.) to command excessive price increases even while demand for their products and services was falling. In competitive markets, when demand falls, prices fall.

To rely, as the Administration did, on monetary and fiscal policy to break inflationary pricing practices in non-competitive markets which are relatively insulated from the effect of such policies, it is necessary to engineer a prolonged recession, driving unemployment to extraordinary levels to reduce demand. Yet, driving up unemployment to break the pricing power of non-competitive industries is, as we are learning, politically unfeasible.

The longer the current recession is allowed to continue, the longer workers will remain unemployed and not contributing to social security. The longer we refuse to develop an effective micropolicy to deal with administered pricing practices in non-competitive markets, and permit concentrated industries large and continuing profits wholly unjustified on the basis of production costs and fair rates of return, the longer will the social security system and its beneficiaries be victimized. While a short-term deficit already exists, there can be no doubt that by controlling inflation and putting people back to work, the deficit will not grow worse and may be improved.

⁶ See Table III in the Appendix A, pg. 22 for comparison of the short-term rates used by the Trustees in their 1974 and 1975 reports for average covered wages, the CPI and unemployment.

⁷ Staff of the Joint Economic Committee, "Inflation and the Consumer in 1974," 3 (February, 1975)

(hereinafter referred to as Joint Eco. Com. Staff Study).

⁸ Joint Economic Committee, "Achieving Price Stability Through Economic Growth," H. Rept. No. 104, 93d Cong., 2d Sess. 30 (Dec. 23, 1974) (hereinafter referred to as Joint Eco. Com. Rept.).

We recognize, that with both Congress and the Executive Branch demonstrating little interest in creating an effective micro-policy to deal with administered price inflation and with a prolonged recession apparently planned by the Administration, prospects for rapid improvement in the economic factors which affect the social security system are not good. Moreover, with an imminent threat of substantially higher world oil prices⁹ (which will, in turn, produce higher domestic energy prices because, to the extent they are not under price controls, they are pegged to the world price and are just as artificial) and with the Administration pressing for decontrol of "old" domestic oil and "new" interstate gas (prices for which would then rise the OPEC level), the upturn in the economy that has occurred in the last few months could be reversed. The Subcommittee must therefore take into account economic conditions in the foreseeable future in determining upon the appropriate remedies to be adopted to eliminate the short-term social security deficit.

III. THE POLICY OPTIONS AVAILABLE TO DEAL WITH THE SHORT-TERM DEFICIT

A. Arbitrary Limitations on Benefit Adjustments under the Escalator

The first alternative available to prevent an aggravation of the deficit which has arisen is an arbitrary limitation on future social security cost-of-living adjustments such as those proposed by the Administration (5 percent effective for June 1975) and the House Budget Committee (7 percent effective for fiscal year 1976).

Our Associations welcomed the cost-indexing of social security benefits in 1972 as a means of preserving the purchasing power of social security benefit levels. We are therefore adamantly opposed to any arbitrary limit on cost-of-living adjustments.

Although we can appreciate the Administration's concern over the rate of growth in income security programs, we also detect an attitude that the aged, who have been chief beneficiaries of this increased spending, have gotten enough, perhaps even too much. We would point out, however, that in 1966, nearly $\frac{1}{3}$ of the aged were living below the poverty level.¹⁰ Even as recently as 1973, over 16 percent of the aged were still in poverty¹¹ (compared with the 11 percent for the total population) and 45.3 percent had total money income below \$4,000.¹² Despite benefit increases, the trend toward a concentration of older family units in the lower extreme of the national income distribution continues.¹³

It must be kept in mind that, with less purchasing power to begin with, the poor and fixed-income aged suffered the most from the combination of inflation and recession in 1974. While the magnitude of their dollar income decline may not have been as great as that of other groups, the decline was from a level that was, at best, marginally adequate.

The impact of the recession and its attendant unemployment has rendered even more difficult, if not impossible, any moderation of the impact of inflation through increased income from active employment. Even in the best of times, the aged encounter a formidable combination of barriers to the labor force. With an increasing number of workers competing for diminishing numbers of jobs, the employment alternative as a means of sustaining purchasing power, is for most of the aged, out of the question.

Less able to offset the impact of inflation through increased income from other sources, the aged are dependent on automatic social security increases under the escalator to maintain the purchasing power of the "real" benefit increases enacted in the last few years. If an arbitrary ceiling were imposed and the inflation rate exceeded the ceiling, the number of aged in the subpoverty group would once again begin to rise—thereby reversing the progress that has been made.

⁹ According to the Joint Economic Committee, soaring energy prices in 1974 resulted in a \$30 billion direct redistribution of income from domestic consumers to domestic and foreign energy producers. Over one half of this enormous sum is estimated to have gone to domestic producers and an additional amount has been paid to U.S. companies for imports of foreign oil or oil products. Its report concluded that, as a result of this transfer, about one fourth to one third of the 12 percent, 1974 increase in the consumer prices was attributable to higher energy prices. (See Joint Eco. Com. Rept. at 104.)

The Congressional Research Service, in a later report (See Lawrence Kumins, Cong. Research Service, Library of Congress, "Administration's Energy Tax Proposals and Related Measures," (Jan. 23, 1975)) found that direct energy price increases accounted for 25 percent of last year's rate of inflation, and when combined with the secondary or "ripple" effects, could have accounted for 35-50%.

¹⁰ See Chart I in Appendix B, p. 26.

¹¹ See Charts I and II in Appendix B, p. 26.

¹² See Table IV in Appendix A, p. 23.

¹³ See Table V in Appendix A, p. 24.

B. An Increase in the Payroll and Self-Employment Tax Rates

Our Associations would oppose an attempt to solve the short-term deficit by increasing the 5.8 percent tax rate on employees and employers. Since the payroll tax system is regressive in nature, the burden of the taxes falls disproportionately upon lower paid workers. Moreover, since we believe that the burden of the employer portion of the payroll tax is in reality borne by labor (either in lost wages or higher prices), current rates are substantial and should not be increased beyond the increases already scheduled in the law.¹⁴

The Joint Economic Committee's staff study, "Inflation and the Consumer in 1974,"¹⁵ that was released in February, found that the increase in personal income and social security taxes for a lower budget family rose 31 percent and 13.8 percent respectively¹⁶ last year. In the case of the intermediate and higher budget family units, the rates were about 26.5 percent and 21.6 percent.¹⁷ Because wage increases were received to offset last year's excessive rates of inflation, individuals paid higher social security taxes and were thrown into higher federal income tax brackets. As a result of this and higher prices for goods and services generally, real disposable income declined by 3 percent last year. This is the first recession in which the tax burden (prior to the enactment of the Tax Reduction Act) actually rose rather than fell.

C. Legislated Increases in the Social Security Contribution/Benefit Base

Another means of generating additional revenue for the system would be through an increase in the contribution/benefit base over and above those presently projected under the automatic provisions of the present law.¹⁸

While we recognize that increasing the base would make the social security tax structure less regressive and, at the same time, would increase benefits to be received in the future by those who would be affected by the higher base, we do not believe that this method should be relied upon as the *sole* means of eliminating the deficit.

We recognize that the effective date of any such legislated increase could be delayed until 1977 in order to prevent taxing away dollars of moderate income family units whose spending and saving is essential to ending the current recession. The appropriateness of this policy, however, is contingent upon the assumption that by late 1977, we will be well on our way to economic recovery. As we suggested earlier, that assumption is risky. Moreover, we point out that the Advisory Council considered an increase in the base to \$24,000 (effective in 1976) but rejected it on the grounds that raising a limit would cause social security to interfere with private savings and capital formation.¹⁹

D. The Advisory Council's Proposal to Use General Revenues to Finance the Hospital Insurance Program and Reallocated the Hospital Insurance Portion of the Payroll-Self-Employment Taxes to the Cash Benefit Programs

Our Associations support the use of general revenues for an expanded and consolidated Medicare and Medicaid program. To this end, we have developed the Comprehensive Medicare Reform Act²⁰ which was introduced by Senator

¹⁴ We would not, however, oppose an increase in the OASDI portion of the self-employment tax from the present 7% to 7.425%. Since the self-employed receive the same benefits as those subject to the payroll tax, and should, because they are both employers and employees, pay the same total rate imposed under the payroll tax (9.9%), we think it fair to peg the OASDI portion of the self-employment tax at 75% of the total OASDI portion of the payroll tax rate—the level at which it used to be fixed.

¹⁵ See footnote 7.

¹⁶ See Joint Eco. Com. Staff Study at 7.

¹⁷ *Id.* at 8.

¹⁸ The AFL-CIO has called for an increase in the base to \$28,000 in graduated steps. Mr. Robert M. Ball, former Commissioner of Social Security, has called for an increase to \$24,000 in 1977.

¹⁹ The Report states: "It [increasing the base to \$24,000] certainly would extend coverage to a level of income where enforced savings seem inappropriate, and where it could further reduce needed capital formation." (See Advisory Council Rept. at 62.)

²⁰ Our Association's health bill—the Comprehensive Medicare Reform Act (S. 1456, 94th Cong., 1st Sess. (1975)) would combine Medicare (and Medicaid to the extent that it applies to the aged) and would provide comprehensive health care protection for the aged and disabled by: (1) eliminating durational "spell of illness" and "post-hospital" limitations on items and services already covered under Medicare, (2) adding additionally-needed health care services, such as intermediate care facility services, eyeglasses, hearing aids, and examinations therefor, dental care and outpatient drugs, and (3) eliminating the Medicare combination of deductibles, coinsurance, copayments and premiums which have become such a heavy burden to the aged and disabled in the last few years. These existing cost-sharing devices would be replaced with simple system of minimal copayments applicable to the more costly items of health care; however, even these would be subject to a catastrophic protection feature pursuant to which everyone who is covered and who is at or below the poverty line would pay no cost-sharing amount. With respect to persons above the poverty level, the catastrophic feature would take hold after the individual had incurred expenditures in an amount related to his income but in no event more than \$750 per family during a calendar year. The bill would also reform Medicare payment procedures to restrain health care inflation. The additional Medicare costs under this would be financed from general revenues and would be added to the existing HI component of the payroll-self-employment taxes.

Ribicoff (D-Conn.) on April 17, as S. 1456. We do not, however, support the Advisory Council's recommendation that Medicare should ultimately be financed solely from general revenues, with the HI portion of the payroll/self-employment taxes reallocated to the cash benefit programs. We believe that the continued use of the HI taxes is necessary to continue the concept of a right to benefits and avoid any introduction of a "means" test for eligibility.

E. Limited Use of General Revenues in the Cash Benefit Programs

Our Associations urge upon this Subcommittee our proposal to finance cost-of-living cash benefit adjustments, to the extent that they exceed 3 percent per year out of general revenues beginning in 1976. Whenever inflation does not exceed 3 percent, no general revenues would be used.

We believe that the ultimate responsibility for maintaining low rates of inflation and high rates of unemployment rests with the federal government. To the extent that the government acquiesced in the administered pricing practice and resorted to monetary and fiscal policies that were in effect, enforced unemployment, we do not believe that the burden of financing the social security deficit that results from this combination should be thrust upon workers who, along with fixed income people, are the victims rather than the beneficiaries of this unprecedented economic situation.

We acknowledge that financing excess cost-of-living adjustments in this manner could add to the federal deficit next year if additional general revenues are not generated through the federal income tax or federal expenditure priorities are not changed. However, if the economy does not respond as we hope by next year, such deficit spending might be desirable. If, on the other hand, the economy is strongly on the way to recovery, then we would suggest that, to the extent general revenues are earmarked to maintain the purchasing power of social security cash benefits, the Congress could, through the federal income tax structure, selectively place the burden of the increased income tax that would be necessary on those who profited most from inflation and who should pay the cost of the inflation they helped produce through administered pricing.

While it would be possible to extend our proposal and use general revenues to finance the costs already accrued as a result of this month's 8 percent cost-of-living increase, we would be willing to support legislation that combines our proposal with a modest legislated increase in the contribution/benefit base effective in 1977 to provide the additional revenues needed to eliminate the short-term deficit. To thrust the full burden of the short-term deficit onto workers, thereby restraining an improvement in their real disposable income situation and holding down their spending and saving, may prolong even further the present recession. Rhetoric about keeping social security self-financed will not render equitable remedies that are, in the context of what has happened, inequitable.

IV. CONCLUSION

In conclusion, Mr. Chairman, I would like to reiterate the points we have made. First, we urge that the Congress enact legislation this year to deal with the social security short-term deficit. Action now by the Congress will restore confidence in the soundness of the system on the part of the many millions of persons who are served by it and who cannot help but be disturbed by the depletion of the cash benefit reserves.

Second, we oppose the imposition in the future of any arbitrary limit over cost-of-living benefit adjustments.

Third, we oppose an increase in the payroll tax rates beyond those already scheduled (but would support, with respect to the self-employment taxes, a return to the former rule whereby the OASDI portion of the self-employment tax was pegged at 75 percent of the combined employer-employee components of the OASDI portion of the payroll tax).

Fourth, we do not favor financing the short-term deficit *solely* out of a substantial legislated increase in the social security contribution/benefit base.

Fifth, while we support the use of general revenues for an expanded and consolidated Medicare program, we oppose the Advisory Council's proposal to finance the present Medicare program from this source and reallocate the HI portion of the payroll-self-employment taxes to cash benefits.

Sixth, we urge that, beginning in 1976, to the extent that cost-of-living benefit adjustments exceed 3 percent, the cost of such excess adjustments be financed from the general revenues with the choice between deficit spending, the reallocation of federal spending priorities, or selective federal income tax increases contingent upon economic circumstances prevailing from year to year.

Finally, to the extent that additional revenue is needed to finance the short-term deficit over and above that which would come from general revenues, we would prefer to see that revenue derived through a legislated increase in the social security contribution/benefit base over and above the \$16,500 base that is projected for 1977.

APPENDIX A

TABLE I.—ASSUMED PERCENTAGE INCREASE OVER PRIOR YEAR IN ANNUAL AVERAGE WAGES AND IN ANNUAL AVERAGE CPI

Calendar year:	Increase in wages	Increase in CPI	Assumed annual average un- employment rate
1975.....	6.2	9.0	8.8
1976.....	9.0	6.6	8.0
1977.....	11.0	6.5	7.0
1978.....	8.8	5.7	6.2
1979.....	7.7	4.6	5.4
1980.....	7.0	4.0	4.8

Source: Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, 1975 annual report, 36 (May 1975).

TABLE II.—PROJECTED "CURRENT COST"² OF OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE SYSTEM AS PERCENT OF PAYROLL,³ UNDER VARIOUS DYNAMIC ASSUMPTIONS, FOR SELECTED YEARS, 1974-2045

Calendar year	Dynamic economic assumptions ⁴						
	5-3	5-2	5-4	6-3	4-3	6-4	4-2
1974.....	10.67	10.33	10.35	10.33	10.33	10.35	10.33
1985.....	10.44	9.63	11.64	9.33	10.96	10.49	10.20
1990.....	11.03	9.76	13.00	9.53	12.15	11.25	10.77
1995.....	11.25	9.53	13.98	9.44	12.94	11.69	10.93
2000.....	11.31	9.10	14.71	9.19	13.48	11.92	10.84
2005.....	11.69	8.88	15.74	9.14	14.23	12.39	10.89
2010.....	12.69	9.16	17.71	9.60	15.82	13.55	11.56
2015.....	14.14	9.78	20.55	10.43	18.15	15.27	12.68
2020.....	15.71	10.48	23.80	11.37	20.84	17.24	13.95
2025.....	16.97	11.01	26.86	12.16	23.29	18.99	14.97
2030.....	17.60	11.14	29.05	12.53	24.92	20.12	15.42
2035.....	17.68	10.89	30.15	12.45	25.62	20.50	15.30
2040.....	17.63	10.57	30.97	12.26	26.05	20.66	15.04
2045.....	17.86	10.39	32.08	12.19	26.74	20.98	14.95
Average cost ⁵	13.89	10.05	20.41	10.66	17.96	15.20	12.60

¹ Source: Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds, 1974 annual report, H. Doc. No. 313, 93d Cong., 2d sess. 44 (1974).

² Represents the cost as percent of the year's total outgo, including amounts needed to maintain the funds at about 1 yr. outgo.

³ Payroll is adjusted to take into account the lower contribution rate on self-employment income, on tips, and on multiple-employer "excess wages" as compared with the combined employer-employee rate.

⁴ The 1st of the 2 figures represents the assumed ultimate annual percent increase in earnings after 1980, while the 2d figure represents the assumed ultimate increase in CPI.

⁵ Represents the arithmetic average of the "current cost" for the 75-yr. period 1974-2048.

TABLE III. 1—COMPARISON OF THE SHORT-TERM ASSUMPTIONS WITH RESPECT TO AVERAGE WAGES, INFLATION AND UNEMPLOYMENT² USED IN THE 1974 AND 1975 OASDI TRUSTEES REPORTS

[In percent]

Calendar year	Trustees increase in wages		Trustees increase in CPI		Trustees assumed annual average unemployment rate	
	1974	1975	1974	1975	1974 ²	1975
1975.....	8.5	6.2	5.7	9.0	5	8.8
1976.....	8.0	9.0	4.5	6.6	5	8.0
1977.....	7.6	11.0	3.2	6.5	5	7.0
1978.....	5.5	8.8	3.0	5.7	5	6.2
1979.....	5.5	7.7	3.0	4.6	5	5.4
1980.....	5.5	7.0	3.0	4.0	5	4.8

¹ Source: Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds, 1975 annual report, 36 (May 1975); Board of Trustees of the Federal Old Age and Survivors Insurance and Disability Insurance Trust Funds, 1974 annual report, H. Doc. No. 313, 93d Cong., 2d sess. 44 (1974).

² The only reference to projected employment rates in the 1974 report appeared in the appendix where the trustees indicated that their long-range financing projections were consistent with an average unemployment rate of 5 percent. Since their long-range projections incorporate their short-term projections, the 5 percent unemployment rate was used in the above table.

APPENDIX B

TABLE IV.—1973 ANNUAL INCOME BY AGE,¹ PERCENT OF POPULATION,² BY INCOME LEVELS

Current total money income	Age 65 and over			Age 25 to 64		
	All consumer units	Families	Nonfamily persons	All consumer units	Families	Nonfamily persons
Under \$1,000.....	2.8	0.8	5.3	1.9	1.0	6.2
\$1,000 to \$1,499.....	4.9	1.1	9.7	1.1	.5	4.2
\$1,500 to \$1,999.....	6.9	2.0	13.0	1.5	.8	5.0
\$2,000 to \$2,499.....	8.9	3.1	16.1	1.7	.9	4.9
\$2,500 to \$2,999.....	8.6	4.9	13.2	1.5	1.1	3.4
\$3,000 to \$3,499.....	7.1	5.5	9.0	1.7	1.3	4.0
\$3,500 to \$3,999.....	6.1	5.8	6.5	1.6	1.3	3.5
\$4,000 to \$4,999.....	10.8	12.4	8.9	3.9	2.9	8.5
\$5,000 to \$5,999.....	8.3	10.6	5.3	4.0	3.2	7.7
\$6,000 to \$6,999.....	6.3	8.8	3.2	4.2	3.6	6.7
\$7,000 to \$7,999.....	4.4	6.5	1.8	4.7	4.3	6.9
\$8,000 to \$8,999.....	4.0	5.7	1.8	5.1	4.7	6.8
\$9,000 to \$9,999.....	3.0	4.2	1.4	4.9	4.8	5.5
\$10,000 to \$11,999.....	4.5	6.7	1.8	10.9	11.4	8.8
\$12,000 to \$14,999.....	4.8	7.6	1.2	15.1	16.4	8.8
\$15,000 to \$24,999.....	6.0	9.9	1.3	26.8	30.8	7.4
\$25,000 to \$49,999.....	2.0	3.4	.4	8.4	9.9	1.2
\$50,000 and over.....	.6	1.0	.1	1.0	1.1	.5
Midpoint (median).....	\$4,441	\$6,426	\$2,725	\$12,243	\$13,500	\$7,367
Arithmetic average (mean).....	\$6,696	\$9,029	\$3,772	\$13,681	\$14,965	\$7,533
Percent under \$4,000.....	45.3	23.0	62.2	11.0	6.9	31.2
Percent over \$12,000.....	13.4	21.9	3.0	51.3	58.2	17.9

¹ Tabulation developed from table 25, "Consumer Income Current Population Reports" p: 60, No. 97.

² Age population based on March 1974 "Current Population Reports Estimate."

APPENDIX B
TABLE V.—FIFTHS OF FAMILIES RANKED BY SIZE OF MONEY INCOME BY AGE, 1952, 1962, AND 1972—FAMILY INCOME

Age of head in total years	Total		Lowest fifth		2d fifth		3d fifth		4th fifth		Highest fifth		Top 5 percent	
	1952	1962	1952	1962	1952	1962	1952	1962	1952	1962	1952	1962	1952	1962
	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Total----	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
14 to 24-----	5.2	5.5	7.1	7.7	8.0	8.5	12.4	12.4	3.7	3.4	1.3	1.6	3.3	5.2
25 to 34-----	23.6	19.3	13.8	22.0	26.1	21.9	23.7	29.5	28.7	22.4	19.7	12.7	9.2	7.3
35 to 44-----	23.8	24.4	14.8	19.7	22.2	20.8	16.0	25.2	28.4	30.8	24.3	29.3	25.6	24.0
45 to 54-----	19.8	20.8	16.1	16.1	17.0	17.3	14.9	18.6	21.0	22.8	25.8	26.5	31.7	33.1
55 to 64-----	14.0	15.0	17.2	14.9	14.0	14.4	15.3	12.9	11.9	14.7	16.0	19.0	18.4	22.0
65 yr and over--	13.0	14.5	30.1	14.0	12.7	17.1	17.6	7.8	6.4	5.9	7.9	7.2	5.9	6.0

Source: U.S. Bureau of the Census, Current Population Reports, Series P-60, No. 90, "Money Income in 1972 of Families and Persons in the United States," U.S. Government Printing Office, Washington, D.C., 1973, p. 40.

APPENDIX B

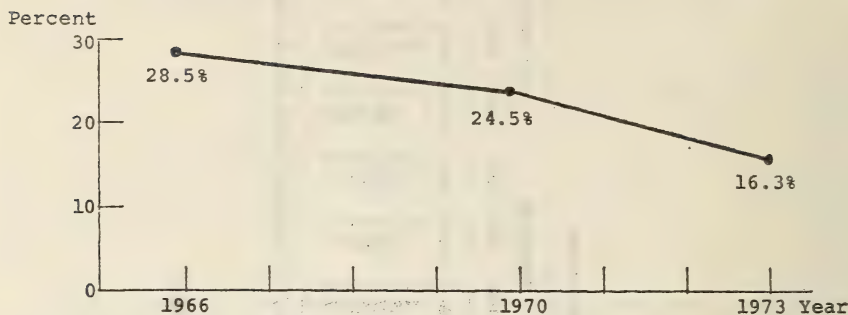


CHART I.—Persons age 65 and over in poverty.

Source: U.S. Bureau of the Census.

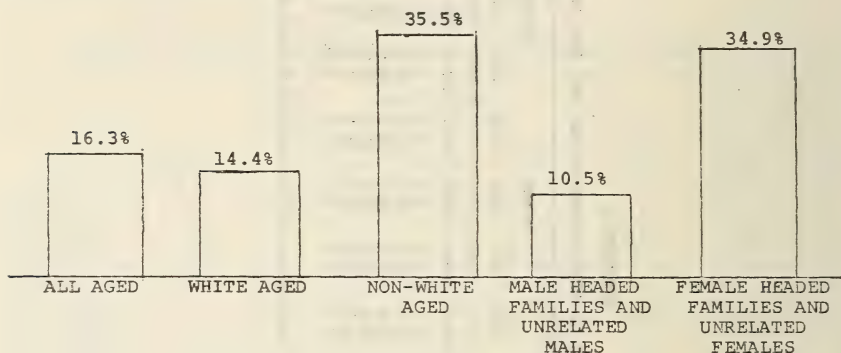


CHART II.—Aged poverty in 1973, selected characteristics.

Source: U.S. Bureau of the Census.

Mr. BURKE. Thank you very much, Mr. Fine.

Mr. Archer.

Mr. ARCHER. Mr. Fine, you mentioned that inflation was caused by the administration. I first thought I understood what you meant but then as you went on I am not sure that I understand what you meant by the administration causing inflation. Could you define the administration for us?

Mr. FINE. Well, I would say the administration is the executive and legislative branches of government.

Mr. ARCHER. Normally when we speak of the word "administration" we are talking about just the executive branch, and I assume you are not limiting your comments to the executive branch.

Mr. FINE. No. I would say it has come about through political action favoring those industries where a few companies have control over the market to the extent where they can actually raise prices in the face of declining demands.

Mr. ARCHER. You also, I am sure, would say that a big part of inflation was caused by a deficit spending of the Government branches both administration and Congress. Would you not?

Mr. FINE. That, of course, Jim Hacking would like to speak to if you don't mind.

Mr. HACKING. The type of inflation you are referring to, excess, is certainly the type of inflation we have had and we may have it again. However, that is not the type of inflation we have last year. You can't have a situation where almost 9 million people are unemployed which is conclusive proof of weak demand and at the same time have too much demand. They are mutually exclusive. You have to look elsewhere for the causes of the record of inflation we had last year and if you look some may say that, well, it is the result of wage push pressure. Too many big wage settlements were made, but then if you look at the statistics every single measure of purchasing power that is used declined last year and the broadest measure of all, real disposable income, fell.

If nothing else, this shows workers were not keeping up with the cost of living so you had to look elsewhere for the sources of last year's record inflation which continues. And you have to look at the revenues that the administration resorted to to control that inflation. They were remedies which were restrictive monetary policy and the result of that is to force a substantial number of people out of work.

The cost of that sort of thing is incredible. They could have resorted to some other policies, the investment of effective micro-policies where they would contribute to an independent policy.

Mr. ARCHER. I suppose it does not serve any real purpose to get into a long philosophical discussion of the causes of inflation but I am intrigued by your comments which are certainly not shared by Webster's Dictionary or economists that I know, that deficit spending has nothing to do with inflation that we have.

But I would rather get into specific comments with respect to the social security program. You mentioned the benefits, Mr. Fine, which have a lag period from the time of the inflation and certainly that is true. But you did not mention the fact that the benefit increases in the last 15 years have been far in excess of inflation and have preceded inflation rather than been a response to it. And certainly I think in all fairness that should be put in the record, too, that the benefit increases have gone up 75 percent in the last 5 or 6 years and inflation has increased only about 40 percent during that period of time.

Mr. FINE. Congressman Archer, I would say in response to that that these substantial increases have come on top of substandard benefits. As a matter of fact, if you look at the benefits you would find it difficult to distinguish where we are dealing with a ceiling or a floor when you compare what people get on public welfare.

So while the increases were, as you say, substantial, we feel that they were on top of substandard benefits. I did not go into that, as you say, because I said this mechanism applies to the future and your point is well taken except we could qualify it.

Mr. ARCHER. Your comment then is that social security has been defective since its inception and it has never paid a benefit that was satisfactory because you can go all the way back to the beginning and you can chart the benefits and they have been in excess of the inflation from the very beginning, during the long-term period of the program.

So basically you just did not approve of the way social security was designed at its inception or at any time during the period of time that it has existed.

Mr. FINE. Personally I think it is a wonderful system. Our criticism is within the context of saying that it is an excellent system but we still can criticize it and say we feel that the replacement ratio is inadequate compared to the replacement ratio in other industrialized nations.

Mr. ARCHER. I would like to get into a couple of other specific points. You mentioned two causes, actually three causes of problems; higher than expected rates of inflation, and higher than expected rates of unemployment, and certainly that has compounded the problem. There is no question about it.

The increased energy prices of course really are not a third factor, in my opinion, but rather contributed to the other two, and helped to bring about the other two.

But you did not mention the congressional action which approved a 20-percent increase in social security benefits without any increase in taxes in the year 1972 and which created by conscious knowledge a better than a 0.7 percent of payroll deficit in the fund.

Then once again in 1973 the majority in Congress approved a 0.5 percent deficit in the fund. And some of those chickens are coming home to roost too in addition to the extra inflation and unemployment.

So the majority in Congress that passed those two bills in 1972 and 1973 have got to bear a share of the responsibility for the problem that is in the fund today.

But that is all past history when we talk about causes. We have the problem and we have to try to do something to solve it.

Your recommendation, as I understand it, is that you would have a small increase in the base presently from \$14,100 to \$16,100 and then let it escalate up in accordance with what is already in the law plus the fact you would pump in some additional general revenue money at this time in an amount that would be necessary to pick up the rest of the slack; is that basically correct?

Mr. FINE. We would go along with the base rate increasing somewhat faster than what is scheduled.

Mr. ARCHER. Well, if you went from \$14,100 to \$16,100 now, that would increase it somewhat faster, would it not?

Mr. FINE. That was the scheduled automatic increase. We would go along on expanding the base wage even beyond that to some extent.

Mr. ARCHER. Specifically what would you expand it relative to a \$14,100 base right now? What would you expand it to?

Mr. HACKING. We don't have the figures for that, for this particular remedy. What we are getting across here is the concept of utilizing general revenues to pay some of this portion plus a legislative increase in tax and wage base over and above what would occur on automatic.

Mr. ARCHER. You don't want to pin yourself down to what percent in the wage increase?

Mr. HACKING. No. We want on the record these are the combinations we favor.

Mr. ARCHER. With respect to general revenue, obviously we don't have any general revenue now. We have got a \$75 to \$80 million deficit that is coming up in the next fiscal year. With that understanding, what is your program to provide the general revenue to make up the difference?

Mr. HACKING. Depending on the circumstances prevailing next year, it may be that we will be well on our way to recovery and if general revenues are taken and earmarked, placed in a trust fund, they should be raised some place either through income tax system or perhaps through a tax system that would penalize those who profited from last year's inflation and are still profiting from inflation.

We are not saying this should come from even a bigger deficit, if that is inappropriate considering the economic issue.

In theory, there are two alternative courses, a shift in Federal expenditures—but we would leave the choice until the time when that decision has to be made because we are not seers and we don't know what the decision is.

Mr. ARCHER. The decision will have to be made. We are not going to have a balanced budget so we have to face up to providing that revenue in one way or another, and that is going to be an added tax and that will have to be borne to a greater extent by the retired people that you represent than it will be by the workers.

Mr. HACKING. Why?

Mr. ARCHER. Because it is going to have to be passed on as a higher cost in the products these people buy.

Mr. HACKING. Suppose that they use another tax, an excess profits tax.

Mr. ARCHER. That will be passed on too. Corporations do not pay taxes. They are merely vehicles to pass them on as a cost of doing business to the people so if you take it off the roll you are putting a bigger tax on the people you represent here today.

Let me get on specifically because we could go on for a long period of time on these. Let me get on the two specific items I want your views on.

One, how would you feel about removing the earnings limitation—

Mr. HACKING. We are in favor of it.

Mr. ARCHER. How would you feel about eliminating on a voluntary basis certain self-employed groups in order to help improve the viability of the funds? Because a self-employed group pays in less than 75 percent and even under your recommendations would pay in only 75 percent of what the employee does. That is total employer-employee contribution. And as a result, they get the same benefit but they pay less into the fund. So they are a drag on the funds economically and fiscally.

How would you feel about permitting some of these groups to opt out so that that would eliminate some of this extra drag on the fund?

Mr. HACKING. We don't favor increases in the rates over and above those that are legislated in the schedule. The Advisory Council said with respect to the OSDI portion of self-employment tax it should be placed at 75 percent, what it used to be. We are willing to go along with that.

But going further and saying it should be equivalent to the combination—

Mr. ARCHER. That is not my question. My question is, How would you feel about letting certain groups voluntarily opt out of coverage of Social Security?

Mr. HACKING. We would be against that.

Mr. ARCHER. Even though they are a drain on the system and are pulling down the funds and helping to create the problems that we have today?

Mr. HACKING. If they are a drain on the system, the amount they are obliged to contribute should be increased.

Mr. ARCHER. In other words, you would increase them up to 100 percent so they would not be a drain?

Mr. HACKING. We would increase them to 75 percent.

Mr. ARCHER. Then they are still a drain.

Mr. WAGGONNER. Do you take that attitude toward every participant in the system.

Mr. HACKING. The system has grown like Topsy.

Mr. WAGGONNER. You just overloaded yourself.

Mr. BURKE. Are there any further questions?

Mr. WAGGONNER. Mr. Fine, you used as an example Party A injuring Party B. Therefore, Party A is obligated to pay for the extent of that injury. Aren't they the same people, really? Aren't they the taxpayers of this country who would pay either through the general fund or the social security trust fund?

Mr. FINE. I don't believe in robbing Peter to pay Paul. There is a difference between a regressive tax and a progressive tax, and a corporate income tax and a personal income tax. I really feel there is a real difference.

Mr. WAGGONNER. You don't believe in robbing Peter to pay Paul.

Mr. FINE. I don't believe these taxes are simply robbing Peter to pay Paul; that there is a difference on the impact, the incidence of the tax. It does make a difference whether personal income taxes are raised or whether corporate income taxes are raised, or if you have a regressive tax, or if you have a graduated tax.

Mr. WAGGONNER. Do you know of a tax that is not regressive?

Mr. FINE. That is not regressive?

Mr. WAGGONNER. Yes.

Mr. HUGHES. Some are less regressive.

Mr. WAGGONNER. Everything we are talking about involves degree and that is wherein our differences come.

Let me ask one other question and then we will let it go.

First, you heard the question I asked of the gentleman from Connecticut a moment ago about whether or not it is possible to provide a financing device to take care of those cost-of-living increases, which serve to deteriorate the stability of the trust fund.

Do you have any idea whether or not that can be done?

Mr. FINE. Congressman Waggonner, to begin with—and this is not personal—I take strong exception to the phrase “cost-of-living increase.” It is actually an inadequate adjustment and if the cost-of-living adjustment proceeds in future years there will still be a gradual erosion in the purchasing power of the older people because of the fact that they pay a disproportionate amount.

Mr. WAGGONNER. Do you know of any better way to describe it then?

Mr. FINE. As we have said here, our emphasis is on utilizing the general funds of the Treasury to pay for the cost-of-living adjustment. Simple as that, and as complicated as that.

Mr. WAGGONNER. I think you just used the phrase you took exception to, “cost of living.” I said “increase.” You said “adjustment.”

Mr. FINE. Because it is not an increase. Nobody gets an increase. In other words, if a person's social security when adjusted for the cost

of living in real dollars, in constant dollars, in real purchasing power is not—

Mr. WAGGONNER. We are talking about semantics. You are saying a cost-of-living increase is an inadequate adjustment. Is that what you are saying?

Mr. FINE. All right.

Mr. WAGGONNER. That is semantics. You used the statistic a minute ago about the elderly and the cost of their care relative to younger groups, and the percentage of the population. You are not blaming the work of God on the social security system, though, are you?

Mr. FINE. No, sir.

Mr. WAGGONNER. I believe you just said we were going to get old and have infirmities when we got old. You accept that at least.

Mr. FINE. Right.

There is one point you made before which I disagree with. In fact, I did agree with you originally and when I brought up the point at one of our meetings I was told I was wrong. I was told the tax is regressive but the benefits are progressive and that is a statement you made. I was told that is not so because the people in the higher income brackets don't live long enough to get back enough money to make it progressive.

This was told me by a top economist on our staff. I was laboring under the same illusion you were.

Mr. WAGGONNER. I don't believe it is an illusion. I think it is a fact of life that relative to the funds paid in you get a higher proportion back.

Mr. CONABLE. Sometimes even economists make mistakes here. I don't want to horrify you but—

Mr. FINE. It is nothing.

Mr. WAGGONNER. We all know we have a problem and we will all help find an answer.

Mr. BURKE. Mr. Jones is recognized.

Mr. JONES. Mr. Fine, the answer that you gave to Mr. Waggonner's last question, is that what you meant in your prepared testimony when you said that the social security tax is not only regressive, but for old people it is also oppressive?

Is that what you meant by your last answer?

Mr. FINE. What I meant when I said it is oppressive is that there is a feeling of tremendous uneasiness and distress among older people in regard to the situation. But basically let's say it is regressive. I will settle for it just being regressive. I get your point.

Mr. JONES. The point then made about the cost-of-living increases, could you tell me whether I am correct or not.

I have heard the real purchasing power of the benefit of today's social security recipient actually is less than that of social security recipient at the inception of the program. Is that correct or incorrect?

Mr. FINE. I will have to defer to Mr. Hughes.

Mr. HUGHES. I think what Mr. Fine was getting at—

Mr. JONES. He did not say that. I heard that somewhere else.

Mr. HUGHES. I could not answer that.

Mr. JONES. I would be curious if you could find an answer to it.

Mr. FINE. I remember when my father brought home \$6 a week and we were living pretty nicely.

Mr. JONES. On the earning limitation lifting, I also support lifting earnings limitation and have a bill to that effect. But the opponents of that say it would just break the viability of the trust fund. Do you have any comments on that?

Mr. FINE. We are not saying the earnings limitation should be lifted tomorrow, done away with entirely tomorrow. Again, we believe in a gradual approach. We feel that if the earnings limitation were gradually eliminated that it would be a viable and sound policy.

Mr. JONES. By gradual elimination, are you saying raising it each year for a few years until it is totally done away with?

Mr. FINE. Gradually, yes.

Mr. JONES. Do you have any levels that you would suggest?

Mr. HUGHES. We are currently calling for \$3,600.

Mr. HACKING. \$4,000.

Mr. ARCHER. Will the gentleman from Oklahoma yield?

We have figures here from the beginning of social security and through December 31, 1973, the cumulative increase in benefits was 390.5 percent from the very beginning and the cumulative increase in CPI was 253 percent. These are the figures as to the purchasing value of the benefits relative to the beginning.

Mr. HUGHES. I think our point, Mr. Archer, was if you have 12-percent inflation nationwide this really does not pertain to the person 65 and over because statistically they spend 90 percent of their income on housing, food, and medical care, and the rate of inflation has been somewhere—I don't recall—I think 18 to 20 percent in those three areas, so I think this is the point we are trying to make here.

In terms of maintaining purchasing power, you can't look at the CPI.

Mr. ARCHER. What you are saying is the CPI is not a valid barometer with respect to the retired people?

Mr. HUGHES. That is correct.

Mr. ARCHER. I have not seen a study on that so I am not in a position to comment.

Mr. FINE. We recommended to the Bureau of Labor Statistics that they devise a special index for the elderly, or for people with low incomes.

Mr. JONES. Let me ask two or three more questions, Mr. Chairman.

First, in answer to Mr. Archer you said you would not support making social security basically a voluntary program.

Would you support, or your organization support, inclusion of all workers, such as Federal workers?

Mr. FINE. Our position is there should be universal coverage. However, I would say as far as the States are concerned—and I have close contact with retirement boards—that there should be an educational process preceding Federal legislation. In other words, I would not like to see Federal legislation which arbitrarily brought State and local workers under the social security system without informing them as to the value of a coordinated system.

I think today there is a great deal of lack of understanding of the benefit of the coordinated system and it would as a result generate tremendous opposition. I know that there would be because at their recent national conference they passed a resolution against it and I

think that resolution might have been based on a lack of complete information.

Mr. HACKING. Could I supplement what he said. As time goes by there are dual benefit problems. Multiple systems have become substantial and it adds to the cost because of all the derivative benefits from social security, and so on. When you have somebody getting a primary benefit from some other system it adds to social security's cost. There is quite a good deal of opposition from groups like civil service to extension of social security to them. They think they have a better system and want to remain independent and separate.

We are aware of the Advisory Council's report and the Advisory Council acknowledge there was a good deal of opposition to this type of an extension.

We don't think, however, it would be impossible to set out some kind of a credit system such that when an individual retires he gets a benefit that reflects his contribution and two systems or multiple systems, and have that benefit paid by the system where he spent his major working career.

Mr. JONES. Let me stop you there. One of the previous witnesses pointed out one of the problems with the social security fund is a worker such as a civil service worker retiring and then working a number of quarters and paying in the minimum number to social security and then getting the minimum benefits—would you change that as far as this educational process? Do you have any recommendations for that?

Mr. FINE. We don't go along with these windfall benefits. We feel that there is an element of inequity there.

Mr. JONES. How would you change it? What recommendations would you make?

Mr. FINE. There should be universal coverage by a coordinated system perhaps with a grandfather clause to coordinate the Federal retirement system and social security.

Mr. JONES. What if political pressures were such that you could not have a universal system and were dealing with the situation exactly as it is, would you make a recommendation to deal with this problem I have just posed?

Mr. FINE. My point is there should be an educational process before. We feel that the universal coverage is basically sound. But it should not be arbitrarily passed.

Mr. JONES. Let's leave the universal system aside. Would you make a preliminary recommendation how we should deal with this problem?

Mr. FINE. Of course principally the Federal employees and State employees are not covered. I don't know if I make my point clear to say we go along with universal coverage providing that the subject is thoroughly explored and both sides have a chance to express their views and exchange views so we come out with a legislative package which represents the interest of all parties concerned through the democratic process rather than an arbitrary one.

Mr. JONES. I just have one final question, Mr. Chairman, and I will admit to having great reservations about going into the General Treasury to fund the disability and the pension part of social security. But I very much think that we perhaps should take all medicare and that sort of thing out of the social security trust fund, and finance

that by the General Treasury. I detect that you are against that. Would you explain why?

Mr. HACKING. The Advisory Council wants to finance the whole program out of general revenues and reallocate the HI portion of the tax. We favor the use of general revenues in medicare for expanded programs but we also keep in the HI portion of the tax because we believe that it is this type of contributory feature where everybody has to pay something that is going to prevent any introduction of a person's test of eligibility for medicare.

We are opposed to financing medicare solely by general revenue.

Mr. FINE. Could I make a few brief comments?

I would like to point out the latest Harris poll found that 97 percent of Americans believe that social security payments to the elderly should automatically increase when cost of living increases and 81 percent believe that the Federal Government has a responsibility to use general tax dollars to help support older persons.

In other words, if Congress did go along with utilizing the general tax funds to a certain extent they would have the wholehearted support of the American public.

Mr. CONABLE. Mr. Chairman, may I ask a question about that?

What do you mean by support older persons? Those in need or those not in need?

Mr. FINE. It said the Federal Government has the responsibility with general tax dollars to help support older persons. Also, they believe, those 97 percent believe social security payments to the elderly should automatically increase—when the cost of living increases, the social security system should automatically increase.

Mr. BURKE. I might point out for the benefit of my colleagues, I took a poll on this 2 years ago and 87 percent of the people in my district favored funds coming out of general revenue for social security.

Mr. JONES. I would like to follow up the gentleman from New York on his question because I would agree that particularly for persons in need that the 81 percent or higher would agree the Federal Government should pay for this out of general revenues. And that is where I think perhaps that would include medical care. That is why I think perhaps we should take medical care out of the social security trust fund entirely.

Mr. CONABLE. Mr. Chairman, the point I am making is——

Mr. BURKE. I am sorry if we upset you, Mr. Conable, but go ahead.

Mr. CONABLE. The point I am making about the issue of social security, whether that should come out of the General Treasury or not, is that social security goes to people who don't need it as well as to people who do need it.

Mr. FINE. I understand your point. I think it is a difference of interpretation of the poll. I took it to mean that broadly the public would support utilizing general revenue tax for Social Security. That is my interpretation. It could be interpreted differently. I acknowledge you could put a different interpretation on it.

Mr. JACOBS. There is always the chance it is just plain wrong.

Mr. CONABLE. The SSI program is based on this same assumption, that General Treasury should support elderly people who are in need. And I wonder if that is not a more sensible use for General Treasury money than to pass out General Treasury money willy-nilly to people qualified for social security, whether or not they need it.

Mr. FINE. We feel we are confronted with an unprecedented situation and as long as it continues we have to use unprecedented solutions.

I might say there is a certain atmosphere of fear today because of the situation and although history may not exactly repeat itself, if 100 years ago at the turn of the century someone had made an accurate long-range forecast for the year 1973 there will be 5 farmworkers to 95 non-farmworkers, I am certain a lot of people would have concluded there would be widespread starvation among the 95.

Mr. WAGGONER. The figure is 98 to 2, though.

Mr. FINE. My point is that there was a technological breakthrough and I don't believe that we have reached the limit of our technological and scientific progress. I think we will make significant breakthroughs in the future and there will be an increase in productivity and that the 100 workers will be well able to support 45 retired persons, perhaps in more comfort than what they enjoy today. That, I think, is the American outlook rather than the pessimistic view.

Mr. BURKE. Mr. Jacobs has a question.

Mr. JACOBS. Do you believe in putting any kind of limitation on unearned income?

Mr. FINE. I personally don't believe in it. I don't know what the position of our association is but my own personal feeling is no.

Mr. JACOBS. If I have \$500,000 of unearned income I should still receive my social security benefits?

Mr. FINE. It is an inequity, that is true, but you can't administratively cope with every inequity.

Mr. JACOBS. Would you cope with it the same way they coped with the earned income limitation?

Mr. FINE. I would separate the two.

Mr. HUGHES. We look at it the other way around. Do away with the limitation altogether and then you do away with the——

Mr. JACOBS. What is it, \$4 billion if you do away with——

Mr. HUGHES. It has been estimated from \$2 billion to \$4 billion.

Mr. JACOBS. Social security estimates \$4 billion.

Mr. HUGHES. I think their position is entirely—they have contradicted themselves, in my opinion, when they say they are against earnings limitations, period. So it has to do with earned or unearned; that is the way I interpret this.

Mr. JACOBS. How do you distinguish——

Mr. HUGHES. If you don't have an earnings limitation you don't have to distinguish because there is no inequity.

Mr. JACOBS. But with the earned limitation you still don't favor symmetry with respect to unearned income. Why?

Mr. FINE. My personal feeling is if an individual has a large unearned income they have earned it.

Mr. JACOBS. I beg your pardon. What was that?

Mr. FINE. My own personal feeling is if a person has a large unearned income they have earned it.

Mr. JACOBS. Let me conclude then by quoting, sir, from a New York magazine cartoon, a fellow who said to his friend in the gentleman's club, "I owe my success to the Protestants' work ethics and one good tip on the market."

Mr. FINE. That is part of the system. I have not benefited from it but I am a little envious of those who have.

Mr. JACOBS. A good tip is earning it the hard way.

Mr. FINE. Someone, Congressman Burke—someone defined aging as doing more and more things for the last time and fewer and fewer things for the first time. This is my first appearance before a congressional committee. It has been quite flattering to have done something for the first time.

Mr. WAGGONER. You have done well.

Mr. BURKE. You acted like a real professional. Thank you very much, Mr. Fine. We appreciate your appearance.

Our next witness is Patricia S. Senger, staff attorney for the Public Citizen Tax Reform Research Group.

Miss Senger, you are recognized. Identify yourself for the record and proceed with your testimony. You may summarize and your entire statement will appear in the record.

STATEMENT OF PATRICIA S. SENGER, STAFF ATTORNEY, PUBLIC CITIZEN TAX REFORM RESEARCH GROUP

Miss SENGER. I will keep my remarks brief. A good deal of what I want to say has sort of been gone over in one degree or another. The reason I wanted to come here is that I don't represent insurance companies or associations of old people or any other sort of groups. I am merely interested in the payroll tax as a tax. And I think that we have to view it as a Federal tax and that this subcommittee has a very broad responsibility to look at it as an overview of the tax.

So far these hearings have concentrated on the narrow question of the deficit, the upcoming deficit this year which is one aspect of the problem that now exists with social security and I fear that we may be looking at a narrow response to that and in so doing make other problems worse.

Our approach generally is that the social security tax as a whole is a regressive tax. There is a smaller and smaller percent of income that is paid as your income increases. It is a very sizeable burden now as I am sure you are aware.

Half the people in this country pay more in social security tax than in income tax. It is no longer a simple contributory tax, that \$30 or whatever it started at. And I think we have to take into account that the rapid increases reflect a change in approach.

Rapid increase in the benefit indicate a change in approach of the system in that it is no longer purely supplementary. It is now discussed as support, basic support for many old people who have no other funds.

Taking all that into account, I think we have to view the fact that it is time to reassess the way in which the tax is collected and the incidence of the burden which now falls very heavily on lower- and middle-income workers.

The proposals that have been most favored by the administration and the advisory council, which would carry a lot of weight here, favor the simple expedient of raising the tax rate 67 percent which will increase this already regressive burden and do nothing to redistribute some of that burden upward as in the wage base.

We would favor, therefore, an increase, immediate increase in the wage base—\$25,000 wage base is the number that has most commonly been discussed although I have no affinity for that particular

number, but it is one that I think there are numerous legislative proposals on and analysis has been done on it and I think it is important for several reasons.

That it raises the base of income which is expected to contribute to the social security system and I think that that is a very important aspect.

You know, as it was brought out already, both the rate and the base will increase over the years and in terms of favoring an immediate response to the deficit I would favor the base and, therefore, distributing the burden over higher income workers as opposed to raising the rate and distributing it over people who already are paying oppressive taxes on social security. There are a number of proposals that have been considered already.

In addition to raising the base of progressive tax rates, general revenue financing, which I think is very important and will have to come although it is not a response to the immediate deficit which is, just by virtue of its not being something that can be done this year and the decoupling proposal which is unstudied now by a panel of actuaries for this subcommittee, and I think that the immediate response has to be in terms of the wage base and strengthening.

For instance—what I want to say—decoupling the system, the benefits to decrease the liabilities, the future liabilities of the system. In addition to that, I also would make the point, being here from Nader, I guess I have a responsibility to put in a consumer aspect, that I agree it is very important we get away from the concept this is purely a contributory system and that is an insurance plan because I think that is the source of a great deal of the fear and the concern that we have been hearing recently from the public.

A few people, I think, have an understanding of how an insurance system works and so words like actuarial unsoundness and things like that are very frightening and people that continue to think of this as a contributory insurance plan will continue to be afraid that the system will not pay for itself in the future.

So I think it is important that we get away from that shoring up that might, that keeps the system going.

I think that concludes what I have to say.

Mr. ARCHER. Then generally you would favor an approach that would make the social security system more of a welfare type program rather than an earned right. Is that the upshot of your testimony?

Miss SENGER. I think it already is, yes.

Mr. ARCHER. So you would ultimately envision folding it into having one welfare program perhaps out of general revenue funds?

Miss SENGER. No, I think I favor, immediately favor the partial funding out of general revenues. That seems to be the most successful plan in other countries and I think a viable way of doing it here.

Mr. CONABLE. You think other countries do a much better job than we do?

Miss SENGER. Well, without getting into all the details of how other countries do it, I could not say but they seem to have fewer problems with the funding of a regressive tax system that we have now.

The point is we don't have the money in the general revenues. We don't have it in the trust fund. It is going to have to be raised somewhere and I would just as soon see it be raised in the progressive tax system as a flat rate,

Mr. JONES. Which country would you suggest we study as a model?

Miss SENGER. I am sorry I don't have that kind of specific information now. The details on which ones.

Mr. JACOBS. Canada is not too bad.

Mr. BURKE. What you recommend on the short-term problem is to raise the wage base from \$14,100 to \$25,000; is that correct?

Miss SENGER. Yes, or whatever if the number that is required—I was working on the same assumptions that the people before me were that the 1 percent increase would remedy the deficit for the next decade or so and a wage base increase to \$25,000 produces about the same revenue gain. And that is how I arrived at that particular number, but, as I say, that is not a magic number.

Mr. BURKE. Do you think we should wait until after November of 1976 to do this or do you think we should take the courageous step this year?

Miss SENGER. I think it has to be done immediately. I think we are talking about short-range answers to short-range problems. And beyond that I think then we have to talk about a whole new aspect of financing which would be general revenue financing.

Mr. STEIGER. You lost me on the consumer aspect of all this totally and so I thought I better go back and reread what I read earlier in your statement.

You say on page 12, "Originally, social security was meant as a supplementary payment to be used with, rather than instead of, private pension plans." Do you think that is still what the purpose is or not?

Miss SENGER. No, but I think that, that the idea was originally conceived that way and the idea of a national rate tax to supply this small portion of income, as sort of pin money as it were, was therefore just a lot more acceptable. But it no longer is just a small supplementary check. It is what many people live on and therefore since we have undertaken a different set of responsibilities through the social security system I think we have to undertake it through a different financing method.

Mr. STEIGER. You do want the social security system to become the sole source of retirement income; is that correct?

Miss SENGER. No. I think for many people it already is. I am not here to put private pensions out of business. That is clearly not it.

Mr. STEIGER. Then where is your consumer education?

Miss SENGER. I think the people have to be aware of what the social security system really is. That it is not a contributory insurance plan. That it does increase benefits according to increases in the cost of living and so on. And that these misconceptions—that is where the consumer aspect of it comes in—enables the system to continue and the tax rates to be raised without the public outcry that would probably result if people understood that it is not nearly the contributory system that it is sold as.

Mr. STEIGER. Thank you, Mr. Chairman.

Mr. BURKE. Do you know whether Mr. Nader would send any letters off to Members of Congress advocating general revenue financing?

Miss SENGER. Not that I know of. We have not sent letters out generally in support of that position.

Mr. BURKE. I wish you would take that subject matter up with him. Are there any further questions?

Thank you very much. We appreciate your appearance.
[The prepared statement follows:]

STATEMENT OF PATRICIA S. SENDER, PUBLIC CITIZEN TAX REFORM
RESEARCH GROUP

Mr. Chairman and Members of this Subcommittee, my name is Patricia S. Senger and I am a staff attorney with the Public Citizen Tax Reform Research Group, which was created by Ralph Nader and supported by public contributions.

I want to thank you for the opportunity to appear before this subcommittee. I would like to start by briefly discussing my purpose here today. I have not come here with predictions of deficits or demographic data, as have the expert panels and administration witnesses. I am here to talk about who pays for the social security system, and how the short range financing problems affect them. My interest is in reminding this subcommittee that one of the most glaring problems with funding the social security system is the way in which the payroll tax is collected. The tax as it now exists is the most regressive federal tax that we have and levies an immense burden on many middle and lower income wage earners. So far the recent concern has concentrated on the amounts collected and I think it would be most unfortunate for the worry over the trust fund deficits to completely overshadow the very real problems of distributing the payroll tax burden more equitably.

This newly created subcommittee is charged with the responsibility for proposing remedies to the many problems now facing the social security system—rising deficits, benefit formulas and higher tax rates. But, to a great extent, this subcommittee has been hamstrung by the current economic situation. The rising cost of living is forcing up the benefits while unemployment is cutting the collections. However, in a recessionary economy, an increase in taxes would be most ill-advised. At the same time, making up any portion of the deficit from general revenues would be very difficult in the face of the huge budget deficits we now have. So it would appear that this subcommittee is left without any viable alternatives.

However, there clearly are several approaches which would reduce the deficit and have a positive affect on the distribution of the burden. It seems to me that the times and the economic pressures demand such a response from this Congress.

Before getting into a discussion of the alternatives I would like to note that my comments are made bearing in mind that the scope of these hearings has been limited to the problems of short term financing. This would appear to mean immediate measures providing short term ways of raising funds rather than long term comprehensive remedies to the underlying problems of the system. This necessarily eliminates any discussion of partial financing from general revenues—a plan proposed by the chairman of this subcommittee—and a major change in the system which would require one third of the cost of social security to be borne through general revenues. This approach has proven itself effective in other countries and soon should be seriously considered by this Congress.

However, political realities and the cost of such a program probably rule it out as an immediate solution. Its advantages are that it not only introduces some measure of progressivity into an otherwise regressively supported system, but it would also make a portion of the income more flexible. Such flexibility would help smooth out trust fund fluctuations in the future. It would therefore be a welcome device to avoid the sort of situation we are now in, where trust fund deficits are a great source of public and congressional concern.

I do not agree with those who speak against general revenue funding out of fear that it will make social security funds too vulnerable to political whims and jeopardize future retirement benefits. A mandatory minimum federal contribution could be written into the law if such protection is needed although it is very difficult to believe that any Congress would risk the political consequences of cutting retirement benefits.

Of course, it does seem unlikely that any general revenue proposal could be passed this year. I think, however, that we can still examine other possibilities which can be acted on immediately and significantly, which will not cancel out the possibility of more comprehensive legislation later.

1. RAISING THE WAGE BASE

For years, responsible critics of the social security system have recommended raising the wage base. It was once again considered by the Advisory Council and rejected, but with a strong dissent by several members. A wage base of \$25,000 would raise about 6 billion dollars (estimated as 10% of income) which would cover the short term deficits, and would also have the effect of spreading the burden of the payroll tax across a larger portion of earned income. The following chart illustrates the effect of an increase in the wage base on the comparative tax rates at different income levels:

Gross income	Payroll tax	Effective tax rate
\$1,000.....	\$58.50	5.85
\$3,000.....	175.50	5.85
\$5,000.....	292.50	5.85
\$10,000.....	585.00	5.85
\$12,000.....	731.25	5.85
\$14,100.....	825.00	5.85
\$15,000.....	825.00	5.5
\$17,500.....	825.00	4.7
\$20,000.....	825.00	4.1
\$25,000.....	825.00	3.3
\$50,000.....	825.00	1.65
\$100,000.....	825.00	.82

The proposals made so far in these hearings to eliminate the deficit have not been at all sensitive to the distribution of that burden.

The administration and advisory council favor decoupling to lower the rate at which the benefit liabilities of the system are climbing, a ceiling on the automatic benefit increases and an increase in the tax rate of about one per cent. Proposals for general revenue financing were specifically and repeatedly rejected. Suggestions for immediately raising the wage base were also rejected. It was reasoned that since people with incomes above the present base of \$14,100 tend to save money, using thrift institutions, it was feared that the additional tax might discourage saving. Since these savings accounts provide a source for corporate capital, the advisory council was reluctant to risk reducing this pool of capital with an added tax.

I think it is important to step back and view those proposals as a whole because what that approach says in essence is that we should increase an already regressive tax which is increasingly burdensome on the middle and lower income workers rather than discourage those better off than they from saving their excess income in banks. Typical of the way in which much of our tax policy is decided, the average working American is considered secondary to the corporate needs of capitalism.

Once it has become obvious that more income is needed, the question of whether to demand it from middle or upper income earners is easily answered. Those above the \$14,100 wage base, presently paying a smaller and smaller percentage of their income as they earn higher and higher wages, should be asked to shoulder the additional tax. Notice, though, that they would not be asked to pay more than any other worker—just to pay the same total tax rate that the poor and middle-income workers already pay. Legislative remedies must first answer the requirements of simple equity before we can try to accommodate the desires of investment bankers for more capital. Furthermore, that same money in the hands of average income workers would likely be spent instead of saved, an important stimulus to the economy.

Raising the tax rate alone, although a quick and simple expedient for raising more money, is an inexcusable solution. It would only exacerbate the existing unfairness. It would increase the burden most on those least able to pay. Such a proposal completely ignores any concern for making the tax more evenly distributed. It is not even a question of progressivity of the tax rate but rather a simple equalizing of the burden between rich and poor.

Along the same lines, and certainly not unimportant, is the need to include non-wage income in the wage base. Presently, investment income is not subject to the social security tax and while there are probably not many people with incomes under \$14,100 with a great deal of investment income that goes untaxed, it should still be included in the wage base.

2. THE EARNED INCOME CREDIT

The earned income credit enacted as part of the 1975 Tax Reduction Act is a refundable credit for low income families completely apart from the other credits and reductions in the Act. Recognizing that many of the qualifying families would already have sufficient exemptions and deductions to exclude them from the income tax base, the sponsors of the credit attempted to provide additional relief from the burdens of payroll taxes. One advantage of this type of payroll tax relief is that the refund is taken from general revenues and not from the social security trust fund.

While this is a roundabout way of lessening the burden on the poor, it is a good way simply because it works. The credit was approved because it did not disturb anyone's notion of contributory insurance and, with Chairman Russell Long's strong backing, was not thought of as welfare.

Several things need to be done to the earned income credit. First, it must be extended since it was only passed for one year. Second, the provisions which limit the benefits to families with dependent minors should be eliminated as they are unwarranted and unfairly discriminatory. Many working couples without children, or with grown children, as well as single workers also deserve some relief from the payroll tax. They should be made eligible when the credit is reenacted.

The earned income credit will not raise revenues to solve the problems of the short range deficit, but, if it is strengthened, it will serve to relieve the tax burden on low income families, especially in light of the projected increases in the tax rate. If, as the administration and advisory council suggest, the rate is raised even more than expected to make up the shortfall in the next few years, the earned income credit will be essential to provide some method of returning funds to the poorest workers.

The earned income credit is not a complete answer to the problem. It is inexact since it can only be considered to offset social security taxes to the extent it exceeds income taxes due, which will differ from family to family. In addition, it is limited to 10% of gross income, while the payroll tax rate is 11.7% when, as most economists suggest, the employer and employee contributions are both considered. So, the earned income credit does not completely compensate the low income worker for the economic loss suffered.

3. EXEMPTIONS AND DEDUCTIONS

Several proposals have come from both Houses over the last few years to enact a system of exemptions and deductions similar to those in the income tax. Some simply apply the low income allowance and standard deduction to the payroll tax (for example bills introduced by Senators Muskie, Mondale, and Nelson and Representatives Seiberling and Reuss). Others have more elaborate ways of setting a floor on the income level which will pay tax, such as Senator Hartke's bill S3494 introduced in the 93rd Congress. Various phaseouts limit the benefits of the exemptions in yet other proposals.

The exemption-deduction system would seem to be a good method of providing relief to low income workers but has great problems politically. It would result in some workers paying no social security tax while still qualifying for benefits. Opponents claim this would turn social security into a welfare program and create all the accompanying headaches. It would destroy the myth of a contributory insurance plan which many people consider important since half the American taxpayers now pay more payroll tax than income tax. Those workers might object to such high taxes if they thought they were going into a welfare program. Furthermore, critics fear it would just open the door to having the type of eligibility problems and means tests that typically plague welfare programs.

The essence of the problem is that the exemption/deduction plan is a threat to the idea of an insurance system. But social security is not an insurance system and it is not meant to be. Obviously, our economy could not stand the monetary drain that would result from having such huge sums of money taken out of circulation to be saved for retirement. While it might be easier for some people to regard those payments as benefits rather than transfer payments, that false image serves to insulate the system from many valid reforms. Workers assume that the huge sums they must pay are necessary to guarantee their future retirement funds and so the system escapes the critical attention and evaluation it deserves.

This subcommittee must face the realities of the social security system and consider the deduction/exemption plans as one very effective way of reducing the burden on low income families. One of the practical problems with these plans

is that they are very costly. It is estimated that the revenue loss would be roughly \$15 billion for the flat exemption system. However, some systems of phased out exemptions have more manageable revenue losses of \$2 to \$4 billion and still achieve the goal of reducing the burden on the very poor.

4. PROGRESSIVE RATE STRUCTURE

A system of rapidly increasing rate steps from a low of 1% on the first \$1,000 up to the current 5.85% could provide relief to low income workers without totally exempting anyone. The wage base and rate structure could easily be manipulated to reduce the revenue loss, or even raise revenues where the wage base was increased simultaneously.

This is a very basic reform and one which would require a great deal of consideration and is, therefore, probably not a realistic proposal for immediate action. But, it is certainly a solution which would answer both the short and long range deficits, and should be given careful attention.

5. CONSUMER ASPECTS

Finally, in regard to this subcommittee's responsibility to remedy the problems of short range financing, those responsibilities go beyond the need to find a way to raise money. It is very important, as some of the expert witnesses have already acknowledged, to reassure American taxpayers that the social security system is not in danger of collapsing. It must be emphasized that the system is sound. But it is very important here to realize that the source of the fear is the misunderstanding that prevails as to what the social security system is. If you think it is an insurance plan, then predictions of collapse and figures showing it to be actually unsound are very believable. Projections of future liabilities are spoken of in the trillions without any explanations—and who but economists and actuaries have any real idea of what a trillion is? The public concern that we are hearing now is the unavoidable result of such frightening predictions. If taxpayers were aware of the actual pay-as-you-go nature of the system, they would realize that their retirement benefits in the future depend only on the government's ability to collect taxes in the future. So there is little possibility that the system will collapse. If the trust fund is decreased, that is a cause for concern, perhaps, but certainly not alarm. Unfortunately, I fear that these rumors of bankruptcy may make the system even more insulated from change if the Congress is afraid to tamper with it for fear of the political repercussions.

Another related problem which has also indirectly affected the short range problem is the increasing public expectation that social security will be their only source of support when they retire. The pressure on the Congress in recent years has been to increase benefit levels dramatically to provide enough money for a decent standard of living for the retired population. Originally, social security was meant as a supplementary payment to be used with, rather than instead of, private pension plans. Since it was designed that way, benefits were low and the tax itself was very low—initially only 1% on the first \$3,000 of earnings. From 1937 to 1960, the tax increased only modestly to 3% of the first \$4,800. It was still considered an additional payment system and there were no real objections to the small flat-rate tax that was necessary to fund it. But in the last 15 years, the payroll tax has soared from a maximum of \$144 to the present \$825. Even taking inflationary factors into account that is a dramatic change which reflects a very real change in the purpose of the social security system. The intent now is to provide a reasonable base of support, but rather than redesign the payroll tax to accommodate a much larger collection responsibility with some degree of equity, the tax rate has simply been increased to an onerous level.

Here again, consumer education is necessary and should be so required by this subcommittee to clarify the aims of the system for the public and members of Congress alike and to emphasize the need for a restructuring of the payroll tax.

CONCLUSION

There are several proposals which this subcommittee should be considering to solve the problems of the short range deficit, without increasing the already regressive burden on low and middle income taxpayers. The administration and advisory council approach of raising the tax rate is the least acceptable method of increasing income to the fund. Raising the wage base would supply adequate funds for the immediate deficit while more comprehensive changes in the total funding plan

are considered, such as partial funding from general revenues. Finally, this subcommittee must not ignore its responsibility to the consumer to demand that adequate explanations of the funding system and the stability of social security be made public to avoid any further public alarm.

Mr. BURKE. Our next witness is Thomas Warschauer, College of Business Administration, University of Maine.

You may summarize if you wish. Your entire statement will appear in the record and all the charts appended thereto.

STATEMENT OF THOMAS WARSCHAUER, COLLEGE OF BUSINESS ADMINISTRATION, UNIVERSITY OF MAINE

Mr. WARSCHAUER. With your permission, I will read a brief segment at the beginning of my statement and then make some additional comments on some of the things that have already been said.

I am afraid that some of the points I am going to have to make today are more or less shocking. Maybe even more shocking than the numbers you have heard in the past.

As Hon. Caspar Weinberger stated in his testimony 4 weeks ago, "There are only three ways to maintain the integrity of the fund. First, we can increase revenues by raising the tax rate. Second, we can increase revenues by extending the wage base on which taxes are collected. Third, we can moderate the projected increase in benefits." Mr. Weinberger went on to argue that the best course of action was to limit the raise in benefits to 5 percent. I wish to object strenuously to that suggestion.

In 1972 Congress adopted, as a matter of law, the principle that benefits would keep pace with inflation. To reject that principle at this early time would, in fact, be to render it null and void, and further to bring about serious question about the intent of Congress for future years. To drop the increase in benefits to 5 percent when inflation causes an erosion of spending power equal to nearly twice that amount is, in fact, an additional tax on senior citizens.

It has been rumored that this committee is leaning toward raise in the wage base—or ceiling—as the best alternative. I will argue that an increase in the wage base would create a financing disaster in fewer than the 25 years under consideration here.

I have only four points to make today. First, the most serious problem of the social security system is that the dynamic system passed in 1972 double counts inflation, and that the solution, in terms of both equity and financing, is the elimination of this double counting. I believe this would solve many of the financing problems projected for the near term and for the long run.

My second point is that efforts to correct the short-term imbalance by raising the wage base would become self-defeating in a very few years.

My third point is that increasing the wage base makes the system's tax even more regressive, not more progressive, as is sometimes erroneously argued.

Finally, I would like to propose that the optimal solutions to the financing problems over the next several years include: One, an increase in the tax rate beginning January 1978 by 0.45 percent over

the current specification to 6.5 percent, and, second, the elimination of the double counting of inflation from the social security system.

Now, let me, if you will, make some comment that I go into somewhat more detail further on in my written testimony. For those of you who have copies of my written testimony if you would be so kind as to look at figure I. It is on page 4. What this chart shows is the double counting. This double counting I am talking about takes place because well once a retiree reaches retirement age benefits are calculated on his average wage up to a ceiling of a number we have been calling the wage base. From the point of view of benefits it could be called a ceiling more properly. And that benefit that would be established at that time keeps pace-with inflation automatically.

That part of the system is fine. There is nothing wrong with that. But in the earlier years, in the years before retirement not only does the whole table, the benefits increase at the rate of inflation but additionally to that, the fact that the ceiling is also increasing at the rate of the average wage base creates a situation that years later results in substantial double counting of inflation.

Now, this chart I referred to here simply shows in real dollar terms—and I state that in real dollar terms—given someone's age, what they would earn if they had always earned the ceiling. And you can see clearly there is a tremendous increase simply because of this increase in ceiling.

Now, it is this problem, this double counting problem, which I think is probably the most serious problem and the one that gives the absurd forecast that one could make with a computer and a few handy programing guides. The result is simply this. That the system does not have the long-run liability that has been suggested simply because of its double counting. This double counting is fairly easy to remedy. The double counting can be remedied simply by allowing the wage base to increase only as quickly as productivity increases are encountered.

Assuming that wages increase for two reasons. One partly because of inflation and partly because of productivity increase. It is for this reason that I argue that a reasonable forecast could be made of retirement benefits were the increase in the ceiling limited to increases in productivity.

If you look at page 6 you can see a much more reasonable future for the system were that change to be made.

I must say that Miss Senger a moment ago stated she was proposing a short-run solution to a short-run problem. What I am doing here is arguing that we don't really have a short-run problem. What we have is a long-run problem and even though these are hearings on the short-run problem by solving the long-run problem we will in fact solve the short-run problem.

There is an initial few years before that impact takes place and that is why I recommend the increase in the tax by nearly a half a percent to take care of that initial change.

But the main point I am trying to make is, in the first place that eliminating this double counting would in fact eliminate many, many of the problems in the long run—and by long urn I mean anything over 10 years—that the situation has.

I would like also to make this, my one other point, emphatic and that is that increasing the ceiling is not a step toward progressivism in the tax. The only reasonable way to measure regressiveness in the social security structure is to look at what you get out in terms of what you put in. And it is incorrect to say that upper income people get out much, much less. People that have made that statement apparently don't have a computer, apparently can't make forecasts on the basis of inflation, because it is apparent that the reason the system is regressive is because the return, the investment characteristics of the social security plan as it is now, assuming reasonable rates of inflation are such that the return is higher in the higher income brackets, not in the lower income brackets.

In fact, anyone representing upper income people should properly be arguing for the elimination of, for the elimination of the ceiling altogether despite the fact we could not possibly afford that. I know what I am saying is backwards of what you have heard and it is based entirely on computer projections but on what I think are fairly reasonable rates of 5½ percent increase in average wages and 4 percent increase in inflation.

That is all I have, Mr. Chairman, and if there are any questions I will be glad to answer them.

[The prepared statement follows:]

STATEMENT OF THOMAS WARSCHAUER, ASSISTANT PROFESSOR OF FINANCE,
UNIVERSITY OF MAINE AT ORONO

Mr. Chairman and Members of the Subcommittee, I appreciate this opportunity to speak with you today with regard to the financing problems of the "cash benefit" segment of The Social Security system. I appear less as an advocate for a specific segment segment of people affected by the social security program, as I do in the capacity of an observer of the system; one who has studied it in some depth.

INTRODUCTION

As The Honorable Casper Weinberger stated in his testimony four weeks ago, "Three are only three ways to maintain the integrity of the fund. First, we can increase revenues by raising the tax rate. Secondly, we can increase revenues by extending the wage base on which taxes are collected. Thirdly, we moderate the projected increase in benefits." Mr. Weinberger went on to argue that the best course of action was to limit the raise in benefits to 5 percent. I wish to object strenuously to that suggestion.

In 1972 Congress adopted, as a matter of law, the principal that benefits would keep pace with inflation. To reject that principal at this early time would, in fact, be to render it null and void, and further to bring about serious question about the intent of Congress for future years. To drop the increase in benefits to 5 percent when inflation causes an erosion of spending power equal to nearly twice that amount is, in fact, an additional tax on senior citizens.

It has been rumored that this committee is leaning toward a raise in the wage base (or ceiling) as the best alternative. I will argue that an increase in the wage base would create a financing disaster in fewer than the twenty-five years under consideration here.

I have only four points to make today. First, the most serious problem of the Social Security system is that the dynamic system passed in 1972 double counts inflation, and that the solution, in terms of both equity and financing, is the elimination of this double counting. I believe this would solve many of the financing problems projected for the near-term and for the long-run.

My second point is that efforts to correct the short-term imbalance by raising the wage base would become self-defeating in very few years.

My third point is that increasing the wage base makes the system's tax even more regressive, not more progressive, as is sometimes erroneously argued.

Finally, I would like to propose that the optimal solutions to the financing problems over the next several years include: one, an increase in the tax rate beginning January 1978 by .45 percent over the current specification to 6.5 percent, and, secondly, the elimination of the double counting of inflation from the Social Security system.

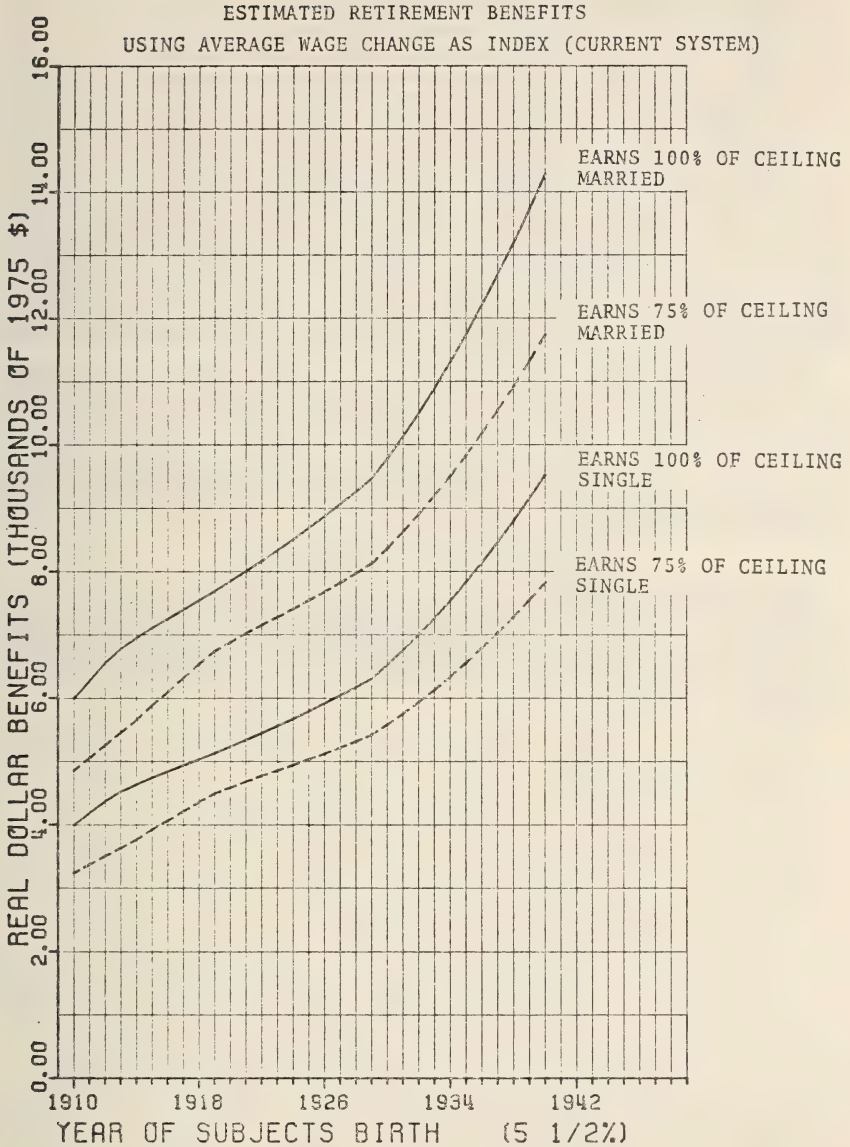
DOUBLE COUNTING INFLATION

It has become clear that in 1972 it was the intent of Congress to create a simple, dynamic system that didn't need continuous tinkering. In an effort to make the system automatically keep pace with changes in value of the dollar, several automatic escalators were included: one which provides that benefits increase with the consumer price index, and a second that indexes the wage base with increases in the average wage paid into social security. On the surface, this dynamic system seemed most proper.

But now that some time has passed, it becomes apparent that this system contains an appalling error: it double counts inflation. After one retires, the Social Security Administration computes a benefit from an "average wage." Benefits are automatically indexed at the rate of inflation. No double counting occurs here. But before retirement while the whole table of benefits is increasing at the rate of inflation, the ceiling or wage base also goes up as fast as the average wage.

Wages go up for basically two reasons: to help "keep pace" with inflation, and because of productivity improvements. The Social Security Administration now projects average earnings increases of 6 percent and inflation rates of 4 percent. I use similar rates of 5½ percent and 4 percent in my projections. Hence, I argue that earnings increases (5½ percent) arise partly (4 percent) from inflation and partly (1½ percent) from increases in productivity.

FIGURE ONE



ESTIMATION OF RETIREMENT BENEFITS

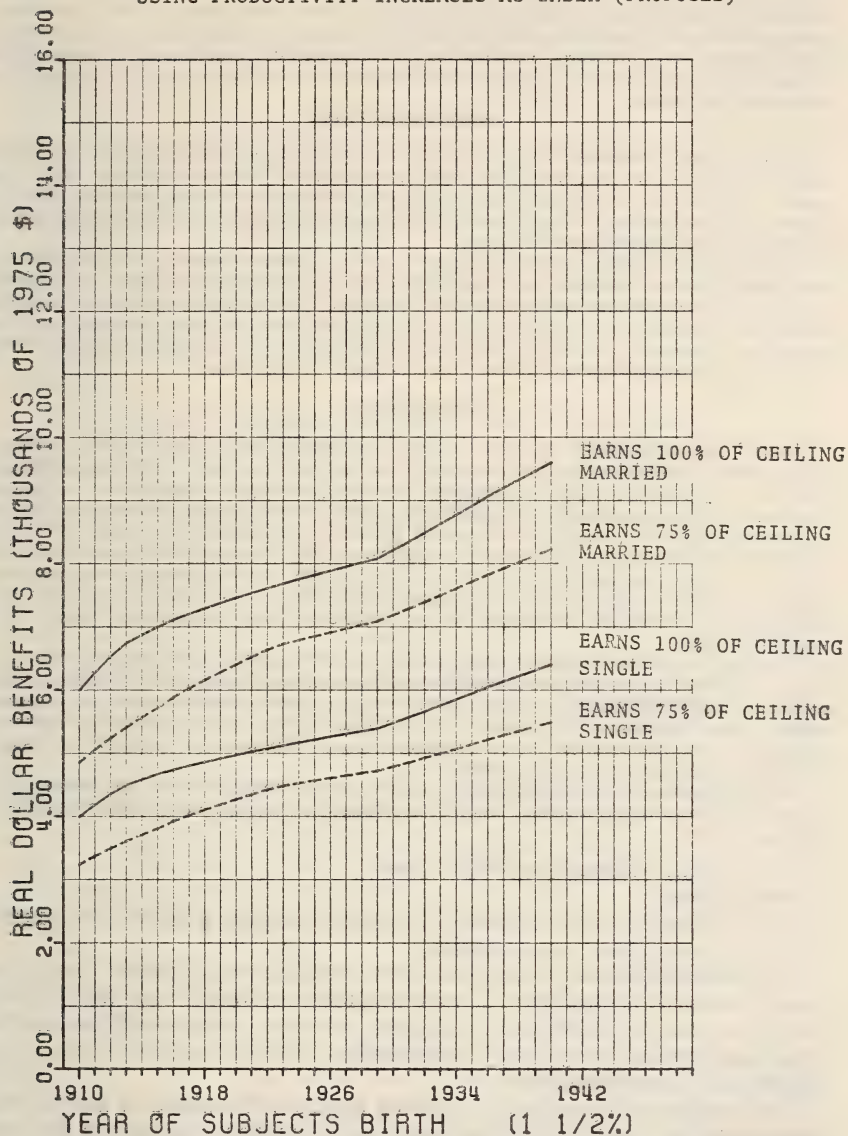
The double counting enters the picture during one's working years. Not only does the entire benefit table increase as rapidly as inflation, but, for people whose earnings are over the ceiling, their averageable earnings, generally increase faster than inflation. It is this essential point that is often missed: not only is the financing related to the wage base/ceilings, but the benefit package is also related to that ceiling. Figure One shows the impact on annual Real Dollar Benefits as today's higher ceilings take hold. This figure demonstrates what benefits would be received if the wage earner made either the wage base in each year of his averaging period or, alternatively, 75 percent of the base. It assumes both the wage earner and spouse retire at age 65 and that the average wage increases at the rate of $5\frac{1}{2}$ percent. Notice that a retired individual, or couple, born in 1940 receives approximately twice the spending power received by their counterpart born in 1915. Thus, it is apparent that double counting leads to enormous benefits in a very few years. This chart is not merely exaggerating the effects of inflation. In fact, it doesn't even show the double affect. Given a 4 percent rate of inflation and a 1930-born married couple whose primary wage earner had earned the ceiling, the real dollar benefit would be \$9,790, as shown in Figure One. However, the actual amount received would be \$21,459 per year.

The correction of this unfortunate double counting is, in fact, a fairly simple matter. Were increases in the wage base/ceiling adjusted only to the extent that wage increases exceed inflation (a productivity measure, of sorts), much more reasonable benefits would result and medium-to-long-run viability would be restored to the system. Figure Two shows this result where a $1\frac{1}{2}$ percent productivity increase occurs. Notice now, that rather than doubling between a 1915-born and 1940-born retired couple, as shown in Figure One, the increase here is held to less than 40 percent.

INCREASED WAGE BASE SOLUTION

My second point relates to the inherent danger in the proposed increase in the ceiling made in an attempt to provide additional revenue. It will only provide a very short-term benefit, will eventually prove a great boon only to the wealthy and, at the same time, would place the long-run viability of the system further in jeopardy.

FIGURE TWO
ESTIMATED RETIREMENT BENEFITS
USING PRODUCTIVITY INCREASES AS INDEX (PROPOSED)



ESTIMATION OF RETIREMENT BENEFITS

What we have been calling the "wage base" from the view of raising revenue should be called the earnings ceiling from the point of view of benefits. Because the benefit formula relates directly to the average earnings of a worker, and the average earnings are computed by averaging a worker's earnings in a certain number of years (never more than 35) up to the ceiling (wage base), the wage base and the ceiling are identical. Hence, any increases in the base now are translated directly to increased benefits for the top-earning one-quarter to one-third of our population. Hence, a short-term financing solution can create longer-term financing problems.

REGRESSIVENESS

It is popularly believed that increases in the wage base have made the Social Security tax less regressive. This is no longer true. For every dollar the wage base is raised the more the investment characteristics of the program benefit the wealthy individual. Thus, those who advocate making the tax more progressive should oppose increasing the ceiling.

In fact, there is only one way to improve the progressiveness of the tax and that is to break the tie between the wage base used in computation of the tax and the earnings ceiling used in computation of benefits. These suggestions stray from the short-run considerations at hand here, and I offer them only as a warning that the expedient alternative of raising the wage base should be opposed by those trying to promote progressiveness in the Social Security tax system.

CONCLUSIONS

Since I argued initially against limiting the benefit table increase to 5 percent as the Ford Administration has proposed, and at length against increasing the wage base as a potentially highly dangerous and truly myopic alternative, I suppose it is incumbent upon me to state the alternative I recommend. Of course, it is the only remaining one, namely a one-half percent tax increase, in steps, by 1978. I would remind you that this is only an additional fifty dollars (\$50) from a \$10,000-per-year worker and certainly no more than \$90 per year additional from anyone. Surely by 1977, when such an increase should begin, our current recession will have passed. However, according to my estimates, this tax will only help for a very short time.

The truly important recommendations I am trying to make is that I urge you not to increase the wage base beyond what the existing legislation provides and to seriously consider limiting increases in the wage base to the amount that average wages exceed inflation. This is surely not to back down on your intent to have an automatic and fair system, but to improve vastly the system's ability to sustain its viability in the decades to come.

Mr. Chairman, let me again thank you for permitting me to discuss these grave issues with the subcommittee. I would be pleased to answer any further questions you may have.

Mr. BURKE. Thank you very much.

Mr. Jacobs.

Mr. JACOBS. Is that because the upper income people live longer? Is that part of your computation?

Mr. WARSCHAUER. I did not even consider that factor and that would make it more true. I was considering simply the fact that a long-run rate of inflation of 4 percent creates, because of the double counting creates very, very substantial benefit returns. Very, very substantial benefit returns.

Mr. STEIGER. If you put the ceiling at \$25,000 instead of at \$14,100, the return for that individual who took it at that maximum \$25,000 is significantly higher, isn't it?

Mr. WARSCHAUER. Yes, sir; that is correct.

Mr. STEIGER. Than others in the system.

Mr. WARSCHAUER. That is right. And it is more that reason I feel that were it to be desired to have a more productive system there are really only two choices possible, one to completely segregate the taxing structure from the compilation of the earnings, from the benefit structure. That would be a radical change in the program. A simpler

change in the program would be to change the computations. That is the reason the double counting comes in because the same numbers are used for two different things. The ceiling is used not only to calculate what the tax is every year but it is also used to calculate what the average benefit is every year. That same number is used by splitting that number then you can make some progress on a more viable system.

Probably it is the only way to make a more progressive system apart from throwing the whole thing into general revenue which would do it.

Mr. STEIGER. Thank you.

Mr. BURKE. Are there any further questions?

Mr. STEIGER. Mr. Chairman, this comment.

The analysis you made I think is fascinating but I must say I don't think it is nearly as shocking as you led me to believe. I was looking for something really extraordinary and you showed good sense.

Thank you.

Mr. JACOBS. Could you shock us just a little before you go. We were counting on it.

Mr. BURKE. Thank you very much for your appearance.

Our last witness for the day is Charles A. Moser of Washington, D.C.

Mr. Moser.

STATEMENT OF CHARLES A. MOSER, WASHINGTON, D.C.

SUMMARY

The long-run financing of Social Security is in considerable difficulty because the power of the state to tax is not infinite. The system of financing we choose for Social Security depends upon our understanding of its nature. Social Security is presently a welfare-type current expenditure system, and in 1975 carries within itself a vast "hidden debt" of at least \$1.3 trillion. Social Security should be made a system embodying private insurance principles of individual equity, financed through a large reserve which will serve as an important source of investment capital.

In order to convert the system from a welfare scheme to one based on insurance principles, we must first recognize the "hidden debt" and make the system actuarially sound through the issuance of "Special Social Security Bonds" financed through general revenues. Then wage-earners will be required to purchase "Social Insurance Bonds" to a given percentage of income from government or private sources. They will have individual equity in these bonds, which would bear interest in such a way to keep pace with inflation. Upon retirement, the worker would be absolutely entitled to the proceeds of his Social Insurance Bonds in the form of an annuity.

Mr. MOSER. Mr. Chairman, members of the subcommittee, I am pleased to be here today to make a statement on the fiscal situation of social security.

I am employed this year by the Heritage Foundation in Washington, D.C., which is a foundation that indulges in public policy research which will support our traditional values of free enterprise approach.

One of my first projects this year was to do a study of social security in which I tried to take a historical and conceptual approach to the whole program so that people can gain a better understanding of why the program is what it is now if they know what the architects of the program thought they were making it in the beginning.

I took care to send copies of that study to all members of the subcommittee when it came out a few months ago but if there are any of you who by chance have not seen it I will be glad to furnish further copies at your request.

Since the argument I make is a little bit intricate and a little off the beaten path I hope you forgive me if I go over it a bit and you will forgive me if I make some fundamental criticism of the social security system as it now exists, because what I basically do is go back to the beginning and say I think the social security system went on incorrect tracks in some important respect from the very beginning and that it ought to be shifted and therefore what we attempt to do is propose a way in which the system could be gotten on these different tracks.

Now, the fact that the long-run financing of social security is in jeopardy is well known these days. The very fact these hearings are being held is evidence of that. There are some who will issue somewhat soothing statements in which they will say the system perturbations are minor and will be resolved with minimum difficulty and in fact prominent economists—who I don't name—once argued the social security system should not be actuarially sound so long as the Government retains the power to tax. Then that taxation will always supply them the money for the benefits in the future and yet we are beset by nagging bits of reality.

Pardon me Mr. Moser. The bells have rung for a rollcall vote.

Mr. BURKE. We will go out and vote and come back and that will give you a chance to relax a bit.

[A recess was taken.]

Mr. BURKE. Mr. Moser, you may proceed.

Mr. MOSER. Thank you.

Now that the nagging bit of reality has been removed perhaps we can continue.

As far as taxation goes for raising revenue, I think we have seen that the present financial plight of New York City demonstrates that even a government possessed of the power to tax can encounter limitations on that power. But even more importantly for our purposes here the railroad retirement system—which has coexisted in a peculiar way with the social security system since the very beginning, and which was only saved from insolvency last fall through the infusion of general revenues—displays in acute form many of the same ailments which plague the social security program and should serve as a serious warning to us.

Indeed, in congressional testimony of last August even social security commissioner, James Cardwell admitted that the future social security may encounter the same problems as railroad retirement, problems arising, in his words from the "declining capacity of the railroad retirement account to collect the necessary taxes to support the benefits provided by the railroad retirement system." That is pretty much the situation to be faced to a certain extent with social security now.

In the case of railroad retirement, the Congress was in a position to save the railroad retirement system because the amount of money involved was relatively small. But if the social security should come to that same pass, then there is no question but what this would be a very serious situation for the country.

Now, the method we chose of financing social security depends partly on our conception of what social security is. If we have a private insurance scheme, which has individual equity and benefits payable directly and mathematically linked to contributions, interest and mortality experience, then we have one thing.

In a beginning system a large reserve is built up at the start, before extensive benefits become payable. That reserve then serves as a principal source of capital accumulation for business. And the system is actuarially sound, which means that at any given point its obligations can be met out of past and future contributions of current participants, regardless of whether any new entrants come into it.

The social security system as originally established in 1935 contained some important private insurance elements, but in a time of economic depression its designers were—needless, I think—worried about the deflationary effect of removing so much money from the economy.

Also, it was stipulated that the greatly truncated large reserve—the social security trust fund—could be invested only in Government securities, that is, borrowed for current Government expenses. And this was appropriate, for if a large reserve had been invested in private securities, it might well have led to the indirect nationalization of American industry.

In 1939 amendments eliminated most of the vestiges of private insurance principles in social security, and moved it toward a welfare-type system of social adequacy, placed on a current expenditure of “pay-as-you-go” basis, in which current benefits are paid from current taxation. The trust fund was reduced to a mere contingency fund. It may go against the grain to speak of social security as a welfare scheme, but most serious students would agree that that is what it is, both because the Supreme Court says so and actually.

If we recognize social security as a welfare program, then we cannot object in principle to infusing general revenues into the system, or even paying for it entirely out of general revenue. Even the ones who think of it as a private insurance scheme would be unhappy with that.

Moreover, at the beginning of fiscal 1974, the OASI trust fund contained less than \$1 billion in cash according to the budget and over \$35 billion in Government securities. If portions of that \$35 billion should have to be liquidated, the money could be obtained only through general revenue taxation or borrowing, so that in fact even the remnant of the large reserve has capitulated to general revenue financing. The Social Security Administration quite adamantly opposed the infusion of general revenues into the social security system, but this is precisely because social security derives much of its widespread—

Mr. JACOBS. Excuse me a moment, Mr. Chairman.

Has a copy of this statement been distributed?

Mr. BURKE. Yes.

Mr. JACOBS. I am sorry. We have summaries here, but not the statement.

Mr. BURKE. Did you get a copy, Mr. Crane?

Mr. CRANE. I have one, yes.

Mr. JACOBS. Thank you.

Mr. MOSER. This widespread public support springs from the fact that people think it is basically a private insurance plan.

Now, one of the early exponents of social security, Edwin Witte of Wisconsin, fought quite vigorously against current expenditure financing. It was 1938, in testimony before the Committee on Ways and Means. When he opposed meeting current expenditure entirely out of current taxation, saying that this would be appropriate only if “there

were no difference between the national income * * * and the income of the National Government," or, in other words, if we had a totally nationalized economy.

Witte also opposed current expenditure financing because—as he realized in 1938—under it “no provision would be made to meet the rapidly accruing liabilities” of the system. He noted with alarm the fact that some had suggested not even keeping a record of those liabilities, so that the Government would “have a vast hidden debt, in addition to the acknowledged Federal debt.”

Unhappily, Witte’s counsel was ignored; but in 1975 we are compelled to be conscious of that “vast hidden debt” of which he spoke in 1938. Last year the Department of the Treasury reported that, as of June 30, 1974, the present value of the system’s unfunded liability was \$2.4 trillion. If we allow for new entrants coming into the system under highly optimistic assumptions—a birth rate of 2.1, a rise in real wages of 2 percent annually, and inflation of no more than 3 percent annually—the present value of the unfunded liabilities drops to \$1.3 trillion. That astronomical figure is a real, optimistic, measure of the longrun fiscal crisis which the system faces.

Moreover, if nothing is done to increase the income of social security drastically, that imbalance will worsen than improve.

The reason for this is time, and compound interest. Under a private insurance system of individual equity, compound interest works to the benefit of the retiree. Under a welfare system of social adequacy, compound interest works against the retiree. The combination gives birth to a sort of scissors effect, and a great gulf opens up between the surplus which would exist under a private insurance scheme, and the deficit which obtains under a social welfare mechanism.

What, then, is to be done?

I begin by stating my basic position: The social security system should be based upon principles of individual equity rather than social adequacy. That, of course, is quite contrary to the way social security has been run for 40 years, and the transition to a system of individual equity from one of social adequacy will be neither easy nor simple. If we are determined to do so, however, we can get from here to there.

The suggestions I make today are slight modifications of proposals made in the latter half of the 1960’s by economists James Buchanan and Colin Campbell.

The first step is the explicit recognition of Witte’s “hidden debt” accumulated over these last few decades, so that we may make provision for current participants in the system who have contributed to it for so long in good faith. We calculate as precisely as we can, and we admit that is not very precisely, the present value of the commitments to future beneficiaries less expected future income at current rates of taxation. By 1975 this figure has no doubt risen substantially above \$1.3 trillion. Then Congress authorizes the Treasury to issue special social security bonds in that total amount, and transfer them to the OASI fund.

Incidentally, I should have mentioned that the payroll taxes would be repealed before we do all this. At that point the fund becomes actuarially sound, and we have met our obligations to present participants. The difficulty in this, of course, is that this huge sum in special social security bonds would have to be financed out of general revenue.

But at least then we would know the extent of our indebtedness, and arrange the Federal budget in such a manner as to deal with it.

Once the social security system is actuarially sound, we may modify it along private insurance lines. First, the payroll tax upon both employee and employer should be repealed. Next, wage earners would be required to purchase social insurance bonds at a certain percentage of income—perhaps 10 percent. These bonds would give the purchaser a claim in equity.

Moreover, wage earners would have the right to purchase additional bonds on a voluntary basis—here I might note that the Social Security Administration at the very beginning almost received the power to issue voluntary annuities to those not covered by the system, but this was deleted and in any case was inconsistent with the latter's character as it quickly evolved.

Finally, the return on the social insurance bonds would be equated with the higher of the following two rates: (1) the rate of interest on long-term U.S. Treasury bonds; (2) the rate of growth in gross national product. This would insure that the retiree would have an equity which had kept pace with inflation upon retirement. Buchanan writes that social security bonds at 10 percent of income "will allow an individual whose income remains wholly stationary over a whole working life to receive a pension that is roughly equal to annual income, provided that we use a 4-percent rate of yield." That would be an outcome considerably more advantageous for the retiree than the current social security arrangement.

Under a system of individual equity, of course, a large reserve would be accumulated. This reserve should be made a primary source of investment capital; a recent book on Sweden points out that, even though a very large fraction of the Swedish economy is socialized, its managers understand the importance of investment better than we, and employ the large trust fund of their equivalent of social security as a major source of capital. In the United States, a social security reserve could be used at first to return investment capital to the private sector through retirement of the public debt. In the unlikely event that the public debt should be entirely retired, the threat to nationalization of private industry through public investment could be obviated by permitting and encouraging private financial institutions to issue social insurance bonds as well as the Government. This would guarantee a continuing and substantial flow of investment capital for the economy while insuring an excellent retirement benefit for the worker.

And, of course, the percentage of the worker's income taken by social security would be below the combined employer-employee tax rate as it is now, not to mention what it will have to be in the future to sustain the system as presently structured.

Under this arrangement, the worker will have an absolute right to his pension at a certain age, and the income limitations and other restrictions which are part of the present welfare-oriented social security system would be abolished.

On the other hand, this would take care only of the income replacement aspect of social security, one who had sufficient income as a worker would continue to have sufficient income as a retiree. Those without sufficient income, whether under or over 65, will be taken care

of through a purely welfare system, as is presently the case with SSI. There would be no minimum social security benefit.

I recognize that these proposals would entail quite a fundamental reorientation of social security, away from what it actually is, and toward what it repeatedly claimed to be, and is in the minds of most Americans. But the Swedes have in part recognized the necessity of such an approach, and Martin Feldstein, in a recent appearance before this subcommittee, suggested something resembling the Swedish system.

The transition to a system of individual equity will be arduous and expensive after we have operated on unsatisfactory premises for nearly 40 years. But the dislocations caused by an explosion of this fiscal time bomb—I hope you will excuse the metaphors in this last paragraph—will be the greater the longer we wait.

I urge the Congress, and this subcommittee in particular, to think very carefully about what needs to be done to restore social security to a fiscally sound footing. If we do not grasp the nettle firmly, we bequeath an even larger and thornier one to our children.

Mr. BURKE. Mr. Jacobs, do you wish to inquire?

Mr. JACOBS. On page 2, sir, at the bottom of the page you define investment in government securities as money "borrowed for current government expenses."

Do you mean that literally?

Mr. MOSER. For the most part, yes.

Mr. JACOBS. What part do you not mean?

Mr. MOSER. This is my understanding, basically, of government securities, is money taken for more or less current government expenditure.

Mr. JACOBS. For example, in 1950 approximately when the B-52 bomber was purchased by the Government, it was purchased by current expenditures. You would not really call that a current expense, would you?

Mr. MOSER. No. No, there are certain elements of government spending which are based on investment which go in the private sector.

Mr. JACOBS. It could not be compared with capital?

Mr. MOSER. If you are talking about income transfer systems, then you have current expenditure, and a great many more of our governmental programs in the last 10 years or so have been of that sort, income transfer systems.

Mr. JACOBS. But at any rate, it would not be proper to say that purchase of government securities is the financing of current expenses of the government. You do recognize the distinction between capital expenditure by government, or whoever it might be, on the one hand, and what we traditionally think of in business accounting as current expenses?

Mr. MOSER. Right.

Mr. JACOBS. Then when you speak of the involuntary purchase of the social insurance bonds by workers, that differs from the present social security tax in what way, in essence?

Mr. MOSER. Well, it is a forced saving system, basically, but it is a forced savings system which works on individual equity as compared—

Mr. JACOBS. Yes, I understand that. But I meant what is the disparity between the out-of-pocket expense for the workers under what we propose and what is being done now?

Mr. MOSER. Well, the disparity, if one took a 10-percent income and one attributed the employer's portion of the social security tax to the employee, then you would have 10 percent as opposed to 11.85 percent, whatever it is now.

Mr. JACOBS. This would be the total, the 10 percent from the employee and the employer.

Mr. MOSER. Yes.

Mr. JACOBS. And would there be a wage base?

Mr. MOSER. No.

Mr. JACOBS. Or if you have \$200,000 of income \$20,000 would be your contribution?

Mr. MOSER. Yes.

Mr. JONES. What would that be in purchasing power, or do to the demand?

Mr. MOSER. It would do a certain amount to demand, but I think it would lead to basically, when you are using investment, the problem now with social security current expenditure is investment under what Professor Feldstein was talking about reduces investment and reduces productivity in the future. Basically whenever you are getting an economy going you have to have investment, you have to collect money, you have to forego present consumption for the sake of future consumption, so basically this is what this type of approach would do.

Mr. CRANE. Are you talking now about what would happen if 10 percent of all earnings in the United States would be immediately invested in the social security bonds?

Mr. MOSER. Yes, in the abstract system. It might be that one could place a certain limit on it.

Mr. CRANE. Well, I am trying to figure out what the impact in terms of what kinds of sums we are talking about there, with the view to meeting capital needs, I mean capital needs presumably in the long run.

Mr. MOSER. I don't think in the short run we would have to worry, no. Because I think while we are employed to getting rid of the public debt, I don't think we can anticipate doing that successfully very fast.

Mr. CRANE. How long would you indicate for doing that under the system?

Mr. MOSER. I don't have any figure on it, but I imagine 40 or 50 years. But still you would have to be meeting current expenditures out of this income so it would not by any means all be applied to reducing the national debt or providing investment capital.

Mr. BURKE. Mr. Jones.

Mr. JONES. No.

Mr. JACOBS. Mr. Chairman, I have one question.

Mr. BURKE. Yes.

Mr. JACOBS. Sir, failing in this scheme generally, and you just might, would you favor taxing the present social security?

Let me say it the other way around. Would you favor the tax for the present social security system as extending to all income, or even all salary and wages, rather than a wage base of \$14,000?

Mr. MOSER. Well, if I may insert something you didn't say, I think should be in there, if it is going to be extended to Federal and State employees, and as a matter of fact, when the system was first debated, we had the Clark amendment and one of the points Senator Clark made when he offered that amendment was Federal employees didn't want to join social security precisely because they had a better pension scheme and if they should be able to opt out then so should other people. But on extending, you are talking about reduced flat tax rate to all of them. I probably would not, simply because I think this would help reinforce the notion that the system is really contributory, when it is not.

Mr. JACOBS. But as a technique for financing, apart from the propaganda and all that, would you in sound economics do that?

Mr. MOSER. Well, I tend to think the support of the system comes more from the earmarking of the tax than the present rate, and one might earmark a tax, not necessarily a flat rate tax, and still have support for the system.

Mr. JACOBS. You don't believe "a rose by any other name"?

Mr. MOSER. Just as Congressman Crane said, I doubt one ought to go all the way in requiring 10 percent bonds, let's say, be bought from earned income. I think I would be against going all the way to flat rate.

Mr. JACOBS. One other question. Whatever it is you went to, would you count as income stock options and all other various kinds of income, let's say a corporate executive would receive?

Mr. MOSER. Then you get into the problem of private pensions, and since private pension funds are one of our main sources of investment income, I am worried about capital investment, and I am not particularly happy about that.

Mr. JACOBS. No, I am sorry, I said stock option plans as bonuses, clearly income.

Mr. MOSER. You are distinguishing this from any sort of private pension plan?

Mr. JACOBS. Oh, yes.

Mr. MOSER. Probably.

Mr. JACOBS. Include that in the calculation, for whatever limitation.

Mr. JONES. So you would have 10 percent of all earnings.

Mr. MOSER. Yes. It might be that you could put a cap on it, and there might be a certain point beyond which——

Mr. JONES. How much would that be?

Mr. JACOBS. Sort of like tithing.

Mr. JONES. How much would that be this year?

Mr. MOSER. I imagine it would be a fairly substantial sum. I haven't done the calculations.

Mr. JACOBS. Too much? Not too much to pay off the national debt.

Mr. MOSER. It couldn't be too much.

Mr. BURKE. What would you do for all the people working now, say for 30 or 40 years, paying into the social security fund? What rights would they have?

Mr. MOSER. They are going to have the same rights they now have, because they have been paying into the system in good faith and Congress has at least a moral obligation to see that they meet these benefits. However, what you are having to do, you are going to have

to pay for now, I suggest we pay off now the bulge, all people paying 1 percent, 2 percent, 3 percent from back in the 1930's when the system was first done. Like a woman who first received benefits received an enormous amount over what she paid in. Somebody paid for that. Instead of letting the social security system go on like some sort of gigantic chain letter, so that the last generation will lose everything, we ought to say, we ought to begin paying on that large indebtedness we have allowed to accumulate and the sooner we begin paying on that the better. But all the people in the system would receive——

Mr. BURKE. What would you do with the existing trust fund?

Mr. MOSER. Well, if you are going to begin the sort of system that we have, then you will have a very large reserve that you can call the trust fund that will be a genuine trust fund, that is, after you got through paying off the national debt, let's say. However, what the trust fund is in fact is a contingency fund, and I would see no objection to just calling it a contingency fund. You have to have it to cover short-term fluctuations in income and outgo, and that you could maintain. But you don't call it a trust fund and thereby give the impression that it is really a large investment fund, which it isn't. And I might say if borrowings were to be made from it, they ought to be made at market rates. I think that is something that interests you, Mr. Chairman.

Mr. BURKE. Do you think the Federal Government has a moral obligation to replace some of the funds that they have siphoned out of the social security trust fund?

Mr. MOSER. I do.

Mr. BURKE. Over the years, as the result of the low interest rates that they have paid on the trust fund?

Mr. MOSER. Yes, sir; I do.

Mr. BURKE. Do you think that should be done out of general revenue?

Mr. MOSER. I suppose that is the only way it can be.

Mr. BURKE. Are there any further questions?

Mr. CRANE. Yes, Mr. Chairman.

On this transition, I am not altogether clear how this would be handled. Say I were 55 today, and I had been paying into the social security program since age 21. Would I as of this date start allocating 10 percent into these social security retirement bonds, and opt out of the present social security program, at age 65 the Government would guarantee me something above and beyond my fair return from the investment in the social security bonds?

Mr. MOSER. Yes, but when you are figuring what happens, is your figure the present value that a worker has 55 percent of his benefits, at age 65 and he is issued bonds in that amount at age 55, that takes care of the obligation of the system up to that point. And then he begins purchasing bonds according to the regular system, he has the bonds which have individual equity which he can begin drawing at age 65.

Mr. CRANE. What would be the immediate impact today of converting all working people under that system with that obligation to the Government?

Mr. MOSER. The immediate impact would be that one would have to find a rather large amount of money out of general revenue to meet the implied hidden obligations of the system.

Mr. CRANE. Have you any idea what that figure would be?

Mr. MOSER. I suspect it would be between \$20 billion and \$30 billion a year.

Mr. CRANE. Well, under the current budget that it is not unmanageable.

Mr. MOSER. Well, I happen to think it is manageable by cutting Government expenditure.

Mr. JONES. Where?

Mr. MOSER. Where? Well, Congressman Crane has been working to some extent on that matter of cutting Government expenditure and the Heritage Foundation, in doing the study called another budget, listed \$20 billion in cuts in Government programs in an appendix. I would be glad to send you a copy of that.

Mr. JACOBS. Could you hit the high points now?

Mr. JONES. Did you include revenue sharing?

Mr. MOSER. We did, yes.

Mr. CRANE. Even the military?

Mr. JACOBS. Why even the military?

Mr. CRANE. Well, because we are oftentimes charged with being partial to the military when talking about economizing.

Mr. JACOBS. I thought you were talking about me because of my service in the military. They say once a marine always a marine. But Barber Conable isn't that way.

Mr. CRANE. Mr. Chairman, I am much intrigued by the testimony earlier and by Professor Moser's testimony today.

I am wondering if it would not be possible in the course of these hearings to get others to testify on this general subject.

You mention two professors here, Professor Buchanan, is he the one down at University of Virginia, or who used to be?

Mr. MOSER. VPI.

Mr. CRANE. VPI. If there are not others, they could spell out in greater detail than we have had here today, or a colloquium between Professor Moser, and see if we could get Mr. Feldstein back.

Mr. BURKE. Well, the record can be kept open if they wish to submit additional statements.

Mr. CRANE. Because it does seem to me that some of the points that are raised here about that fiscal bomb are valid. We are living in an age when we are at less than zero population growth and we have been since 1972. And we have got that post-world war baby boom that will be hitting retirement age somewhere around 2000, I guess, so that we will have an inverted pyramid, with the tax base at the apex of the pyramid and the base of it being the beneficiaries, and what the taxes will be at that time is astronomical.

And you have got the continuing, nagging problem of the ever-increasing benefits that must be paid out of a sense of equity to people who were anticipating that whatever that social security benefit is going to be would cover x percent of their retirement cost, that something like this, and particularly with a Swedish model, where they have already done something along these lines, might involve a major reevaluation of some of the basic premises of the system, with a way out that is more beneficial to the working people during their productive years, but particularly in their retirement years, and simultaneously go far toward meeting the capital needs of the Nation.

Mr. BURKE. Well, we will be happy to set another day if you wish to, if you want to make that request, and see if we can arrange and get these people that you suggest to testify, and get some additional information.

Mr. CRANE. If we could.

Mr. BURKE. We will be pleased to receive any information whatsoever that will help us along that line. I think it is a good suggestion.

Mr. CRANE. I would like to suggest also in that colloquium to have some of those who are familiar with this plan and who disagree with it appear there, too, so that we can have sharper exchange than I feel prepared to engage in.

Mr. BURKE. Yes.

Mr. CRANE. Because I suspect I am not that conversant with this proposal, nor the salient objections to it.

Mr. BURKE. We might be able to set up a panel.

Mr. JACOBS. Would the gentleman yield?

Mr. CRANE. Yes.

Mr. JACOBS. You are suggesting a discussion, really, from various points of view.

Mr. CRANE. Well, discussion of people who are sympathetic with the premise of how we handle this program, plus some of those who are conversant with these alternatives who disagree with the conclusions.

Mr. JACOBS. Mr. Chairman, I think we discussed that at the beginning of our full committee deliberations, and I swear to you that, Mr. Chairman, I don't understand why the Congress does not do that all the time. Because when you hear from one point of view, and without being conversant with it, you don't know the precise questions to ask, doesn't mean—I was answered, I might say to the gentleman from Illinois, when I made the same suggestion at the beginning of this session, "Why can't we have a free-for-all." Well, I don't know that you presume that learned people who come before this committee can't be civil just because they disagree, and I just think this suggestion is perfect and ought really to be considered and implemented.

Mr. JONES. I agree.

Mr. BURKE. Well, I think we can get them together, and have a bell in here.

Mr. JONES. What is that?

Mr. BURKE. I think we can have a bell in here, and if things get rough just ring the bell.

Mr. JACOBS. If things got rough, Mr. Chairman, I know the chairman is from Boston and I don't think would have any problem at all. I think he could "clean house."

Mr. BURKE. I think that is a good suggestion, Mr. Crane, and we will have the staff look into it.

Mr. CRANE. Thank you.

Mr. BURKE. Thank you, Mr. Moser.

This concludes our hearing for the day.

The committee now stands adjourned, to meet at 1 p.m. tomorrow afternoon.

[Whereupon, at 4:15 p.m., the subcommittee was adjourned, to reconvene at 1 p.m., Wednesday, June 18, 1975.]

FINANCING THE SOCIAL SECURITY SYSTEM

WEDNESDAY, JUNE 18, 1975

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The subcommittee met at 1:10 p.m., pursuant to notice, in room H-208, the Capitol, Hon James A. Burke (chairman of the subcommittee) presiding.

Mr. BURKE. Our leadoff witness today is a man well known to the entire committee, Robert J. Myers.

We welcome you here, Mr. Myers. You may identify yourself and proceed as you wish.

STATEMENTS OF ROBERT J. MYERS, SOCIAL SECURITY ADVISER, AMERICAN LIFE INSURANCE ASSOCIATION AND WILLIAM B. HARMAN, JR., EXECUTIVE VICE PRESIDENT, AMERICAN LIFE INSURANCE ASSOCIATION

SUMMARY

1. The Old-Age, Survivors, and Disability Insurance system (OASDI) has serious financial problems, both of a short-range nature and a long-range nature.

2. These problems can be solved without too much difficulty. However, some methods of solving them are desirable, while others are not.

3. The short-range problem is that the OASI Trust Fund will be exhausted in late 1981, and the DI Trust Fund even sooner, according to the 1975 Trustees Report. And it is likely that these estimates are over-optimistic.

4. The long-range problem is that the average cost of the benefit outgo exceeds the average tax rate for the next 75 years by 5.32 percent of taxable payroll, or about 50 percent relatively.

5. The short-range problem can be solved by increasing the employer tax by $\frac{1}{2}$ percent and the employee tax by the same amount. This should be done in 1976 or at the latest in 1977. At the same time, the benefit computation method should be rationally restructured as it applies to new awards so that it is "decoupled" be changing to a wage-indexing procedure with a modified benefit formula.

6. The long-range problem can then be solved by a further similar tax rate increase in the early 1980's. A further increase of about this amount will probably be needed 35 or 40 years from now.

7. The financing problem should *not* be solved either by injection of a government subsidy from general revenues or by increasing the taxable earnings base beyond what the automatic-adjustment provisions will do.

Mr. MYERS. Thank you, Mr. Chairman.

Mr. Harman, from the American Life Insurance Association would like to say a few words first.

Mr. HARMAN. Thank you, Mr. Chairman.

My name is William B. Harman, Jr., I am executive vice president of the American Life Insurance Association, the member companies of

which account for some 90 percent of the life insurance in force in this country and virtually all of the insured pensions. Our association shares your committee's concern that our Nation should maintain a sound social security program and that its citizens should have no cause to doubt that soundness.

In recent years we have utilized Bob Myers' services as a consultant. I do not need to introduce Bob to you, Mr. Chairman, and this subcommittee, nor review his credentials in this field. He has appeared before the Ways and Means Committee many times, and as recently as last month before this subcommittee. I do, however, wish to bring to your attention the fact that Bob's role with the association has been expanded. He will now serve as social security adviser to the association and in that capacity will articulate our position on the important social security issues pending before Congress. It would be very much appreciated if our recent press release announcing Bob Myers' new capacity could be made a part of this hearing record.

Mr. BURKE. Without objection, that will be done.

Mr. HARMAN. Thank you very much.

[The press release referred to follows:]

Washington, D.C.—Robert J. Myers, former chief actuary of the U.S. Social Security Administration, has been appointed Social Security Adviser to the American Life Insurance Association, it was announced today by Blake T. Newton, Jr., president of the association.

Mr. Myers will work with the ALIA's Committee on Social Security and Health Care, and will testify on behalf of the association at Congressional hearings on the Social Security system.

The ALIA has a membership of 378 life insurance companies accounting for approximately 90 per cent of the life insurance in force in the United States. These companies also hold about 99 per cent of the assets attributable to qualified pension and profit-sharing plans with life insurance companies in the United States.

Mr. Myers, who is Professor of Actuarial Science at Temple University, recently served as actuarial consultant to the Advisory Council on Social Security, and in past years has been actuarial consultant to various Congressional committees and to the Federal judiciary. A Fellow of the Society of Actuaries, he is a past president of that body as well as the American Academy of Actuaries.

He also held various actuarial positions with the Social Security Administration from 1934 until he left the government in 1970, serving as Chief Actuary for the period 1947-1970. He is a member of the Wharton School's Pension Research Council, and numerous other pension study groups and committees. Author of many articles on Social Security and pensions, Mr. Myers has written three books: "Social Insurance and Allied Government Programs," "Medicare," and "Social Security."

Mr. MYERS. Thank you, Mr. Burke.

My name is Robert J. Myers, and I am appearing here today on behalf of the American Life Insurance Association. The 378 life insurance companies which comprise the membership of that association account for about 90 percent of the total life insurance in force in the United States and about 99 percent of the assets attributable to insured qualified pension and profit-sharing plans.

Before discussing the financing of the social security system, I should like to point out that, ever since the inception of the social security program in 1935, the attitude of the life insurance business has been one of support and cooperation. However, the life insurance business at times has criticized certain legislative proposals in the social security field as not being in the best interest of the country because they would overexpand the scope of the program, particularly the benefit level.

The life insurance business believes that economic security for the people of this country should be provided in a threefold manner. First, the Government, through social security, should provide a floor of protection universally applicable, on a compulsory basis. Second, there should be private sector initiatives on a voluntary and flexible basis, through both individual and employer efforts, in the form of homeownership, savings and investments, private pension and profit-sharing plans, and insurance. Third, in those relatively few cases where the first two tiers do not provide adequate income, then public assistance programs such as supplemental security income should make up the necessary difference.

The life insurance business believes that, in the best interests of the people of the country and of the Nation itself, the social insurance program should not expand beyond a floor-of-protection level. Thus, social security should not encroach on the resources available to the private sector tier by having an inordinately high benefit level or maximum taxable earnings base. In the same manner, social security should not be overused as an antipoverty weapon, thus supplanting the public assistance tier and overburdening the payroll tax.

The old-age, survivors, and disability insurance system, OASDI, currently has some very serious financing problems. These are both of a short-range nature and a long-range nature. I hasten to point out, however, that these problems are not nearly as serious or catastrophic as some writers in the public press make out. These problems can be solved readily and without overburdening cost effects on the workers and employers of this country. On the other hand, these problems are not trivial, as some people intimate.

There are several ways that the financing problems of social security can be solved. However, as I will discuss later, some of the solutions are undesirable in their side effects.

The short-range financing problem is that, according to the 1975 trustees report, the OASDI trust funds will be exhausted in just a few years, unless additional financing is provided. The year of exhaustion would be early 1980 for the DI trust fund and late 1981 for the OASI trust fund. In my opinion, these official estimates are somewhat too optimistic, because they are based on economic assumptions that the rate of increase in wages will average about 3 percent per year higher than the rate of increase in the CPI during the period 1976-80.

In view of past experience, both in the last few years and over longer periods, this seems very unlikely. Under what I consider to be more reasonable economic assumptions, the trust funds will be exhausted somewhat earlier than in the official estimates—in 1979 for the DI trust fund and in 1980 for the OASI trust fund. This situation gives clear evidence that prompt remedial legislative action should be taken.

The long-range financing problem of the OASDI system is simply that the average cost of its disbursements over the next 75 years, expressed as a percentage of taxable payroll, exceeds the average tax rate over that period by 5.32 percent of taxable payroll, according to the 1975 trustees report. This excess represents about a 50 percent relative cost overrun. On a year-by-year basis, the deficiency is much larger in the far distant future than in the next 25 years, but nonetheless the deficiency in the short range is sizable, as indicated by the previously mentioned estimated early exhaustion of the trust funds.

The long-range financing problem comes about primarily because of two factors that have only a small effect in the next few decades—namely, the significantly decreased birth rates and the instability of the benefit computation method for new retirants that occurs under likely future economic conditions.

The short-range financing problem can be solved by increasing the employer tax by one-half percent and the employee tax by the same amount. This should be done effective in 1976, or at the very latest, 1977.

At the same time, it would be highly desirable to change the benefit computation method as it applies to new retirants or other beneficiaries first coming on the roll to a decoupling approach along the lines recommended by the advisory council on social security and by other witnesses who have appeared before your subcommittee.

Specifically, the past earnings record of the claimant would be indexed according to past average wages in covered employment, and a new benefit formula would be applied to the resulting average indexed monthly earnings. Such a formula would be developed so as to reproduce, for those retiring in the immediate future, benefits which on the average would be very close to those under the present computation method. In addition, there would be a savings clause such that in no case would a lower benefit be paid than under the method applicable as of the time of the changeover.

The advisory council gave only several general illustrative examples of such a revised benefit formula. I would recommend for your consideration the following formula: 100 percent of the first \$135 of average indexed monthly earnings, plus 29 percent of the next \$766 of such earnings, plus 10 percent of such earnings between \$900 and \$1,175. The dollar figures, it should be noted, would be adjusted in years after 1976 to reflect changes in the general level of wages in covered employment.

I might point out that the proposed 10 percent final factor would have little application in the next few years, because very few individuals would have average indexed monthly earnings of more than \$900 until many years hence.

I might also point out that, in my earlier appearance before this subcommittee, on a purely personal basis, I had suggested a 20 percent factor, but upon further study I am convinced that a 10 percent factor would be better. The reason for this is that then, over the long run, the ratio of the primary benefit to the final earnings for the highest paid individuals will be around 31 to 32 percent, or about the same as will prevail in the immediate future, and as has prevailed for many years in the past. Such a basis will not only produce reasonable benefit relationships, but also will result in somewhat lower costs for the program and thus solve, to a certain extent, the long-range financing problem. At the same time, too, such an approach ties in well with the social adequacy nature of the program by providing relatively larger benefits for low-paid workers than for the highest paid ones, or in other words makes the system even more progressive than it already is.

Next, turning to the long-range financing problem, the solution rests not only in the decoupling or rationalization of the benefit computation method just described, but also in the recognition of the higher costs arising from the other factors mentioned previously which will require additional financing. This should be done by a further increase in the tax rate of one-half percent on the employer and a like

amount of the employee in the early 1980's. Another increase of about this magnitude would also probably be necessary some three or four decades from now.

Finally, let me turn to how the financing problems of the OASDI system should not be solved. Some people have proposed the solution of injecting a governmental subsidy from general revenues into OASDI either directly or else indirectly by moving some of the hospital insurance tax rates to OASDI and then injecting a government subsidy into HI. This approach should not be followed for a number of reasons.

Introduction of a government subsidy would dilute the awareness of the public as to the cost of the program, because many would believe that somebody other than themselves would be providing this financing. In actual fact, the general revenues taxation necessary to produce the government subsidy would be paid by virtually the same people who are now paying the payroll taxes—and very likely with not too great a difference in the actual incidence of the taxes.

The injection of general revenues into the time-tested approach of the system being wholly self-supporting from payroll taxes would erode the self-sustaining concept by moving in the direction of a welfare concept that could lead to means testing for benefits. Any general revenue financing in OASDI would very likely lead to a lack of stability in the benefit protection provided, because of the pressures of other programs that can only be financed from general revenues.

Other people have urged that some of the additional financing necessary for OASDI should be obtained by increasing the maximum taxable earnings base beyond what the automatic-adjustment provisions would do. Such a source of additional financing can produce only limited amounts.

Moreover, this is a very inefficient method of producing additional financing, since over the long range about half of the increased taxes would be paid back in benefits to persons who were at the highest income levels. In the short range, a sharp increase in the earnings base would provide undue actuarial windfalls to current older high-paid individuals, who would receive additional benefits having as much as three times the value of the additional taxes that they would pay. Also, raising the taxable earnings base would significantly diminish the area in which the private sector could and should operate to provide economic security.

In closing, I should like to emphasize the strong belief of the American Life Insurance Association in the social security program as a viable and sound floor of protection in the economic security area. We believe that prompt action should be taken to strengthen its financing by an immediate small increase in the employer-employee tax rate and by restructuring and rationalizing the benefit computation method before it gets further out of line. The time-tested approach of financing the program on a self-supporting basis without a government subsidy, involving a maximum earnings base which is consistent with those prevailing in the past quarter century, should be continued.

Thank you, Mr. Chairman.

Mr. BURKE. Thank you, Mr. Myers.

Are there any questions?

Mr. COTTER. Yes. Thank you, Mr. Chairman.

Mr. Myers, you made reference to a floor of protection level. Could you give me and the committee some indication of how far this level should extend?

Mr. MYERS. The floor-of-protection concept, of course, is not completely precise where you can say that, if you go just a little higher, you are beyond the floor, and if you go just a little lower, you don't have a floor.

Mr. COTTER. It is a nebulous figure.

Mr. MYERS. Yes. I am coming to what I consider to be a reasonable figure. I think the way to test whether the social security benefit level is by the extent to which people over age 65 receiving social security have to turn to the Government for additional help in the form of public assistance or supplemental security income. If that proportion of people needing additional Government help is small, then I would say the benefits are at floor-of-protection level.

For many years and currently, those over age 65 who are receiving social security benefits who need additional governmental help have numbered somewhat less than 10 percent of the total, and in my view that is the way to test the floor-of-protection concept.

Mr. COTTER. One other question. Could you give the committee or supply a detailed cost analysis of the proposals which you have made?

Mr. MYERS. Yes. That would be possible.

Mr. COTTER. Do you have any with you now?

Mr. MYERS. I have made cost estimates in three ways. First, I have taken the trustees estimates, which according to law need only run for the next 5 years, and I extended them to the point where the fund ran out, using what I thought were their assumptions. Second, I made similar cost estimates using what I consider to be more reasonable economic assumptions, which tend to be somewhat more pessimistic, and, as I indicated in my testimony, show the funds running out a little earlier. Third, I made a cost estimate showing what would be the effect of increasing the tax rates in 1976 by half a percent on the employer and half a percent on the employee, as I recommended, and then another increase of the same amount later, and at the same time adopting a decoupling proposal for the benefit structure. So, I have those three tables.

Mr. COTTER. You don't have them with you, but you would supply the committee with them and put them in the record?

Mr. MYERS. I have one set with me.

Mr. COTTER. Would you like to make reference to those?

Mr. MYERS. As I indicated, under the trustees estimate, the OASI fund runs out in 1981, and the DI fund runs out in early 1980. Under what I consider to be more reasonable economic assumptions, the OASI fund would become exhausted in early 1980, and the DI trust fund would be exhausted in mid-1979. If the recommendations that I made were adopted, according to my estimates, the OASI trust fund would remain fairly level during the period 1975 to 1979 at about \$36 billion, and then it would increase slowly until at the end of 1983, which is as far as I carried out my estimates, it would have a balance of about \$55 billion. Although this is a very considerable sum in terms of money, it is still not relatively large, because the outgo at that time would be around \$130 billion, so the trust fund would be less than half a year's outgo, which I think is a little on the skimpy side.

As to the DI trust fund under my proposal, it would decrease slightly in the next few years and would be at a level of about \$6 billion until 1980, and then would increase slowly and be about \$9 billion at the end of 1983.

Mr. COTTER. Thank you.

Could we keep the record open for that, Mr. Chairman?

Mr. BURKE. Without objection, the record will be kept open for this analysis.

Mr. MYERS. Mr. Chairman, I could insert these three tables in the record.

Mr. BURKE. Fine. Without objection, they will be included.

Mr. COTTER. Thank you.

[The tables referred to follow:]

TABLE 1.—ESTIMATED PROGRESS OF OASDI TRUST FUNDS ACCORDING TO 1975 TRUSTEES' REPORT

[In billions]

Calendar year	Total income	Total outgo	Net income	Fund at end of year
OASI Trust Fund:				
1975	\$58.6	\$60.8	-\$2.2	\$35.6
1976	63.8	68.1	-4.3	31.3
1977	72.2	76.2	-4.0	27.3
1978	80.1	84.4	-4.3	23.0
1979	88.2	93.0	-4.8	18.2
1980	94.0	101.6	-7.6	10.6
1981	100.0	110.7	-10.7	
1982	106.8	120.4	-13.6	
1983	114.4	130.8	-16.4	
DI Trust Fund:				
1975	7.9	8.7	-.8	7.3
1976	8.6	10.1	-1.5	5.8
1977	9.6	11.3	-1.7	4.1
1978	11.0	12.7	-1.7	2.4
1979	12.1	14.1	-2.0	.4
1980	13.0	15.4	-2.4	
1981	13.9	16.8	-2.9	
1982	14.9	18.3	-3.4	
1983	16.0	19.9	-3.9	

Note: Data for 1975-79 are from Trustees' Report. Data for later years are my estimates based on long-range economic assumptions of Trustees' Report.

TABLE 2.—ESTIMATED PROGRESS OF OASDI TRUST FUNDS ACCORDING TO REVISED ASSUMPTIONS FROM THOSE IN 1975 TRUSTEES' REPORT

[In billions]

Calendar year	Total income	Total outgo	Net income	Fund at end of year
OASI Trust Fund:				
1975	\$58.6	\$60.8	-\$2.2	\$35.6
1976	63.6	68.6	-5.0	30.6
1977	71.9	78.2	-6.3	24.3
1978	79.7	88.2	-8.5	15.8
1979	87.5	98.2	-10.7	5.1
1980	93.2	108.4	-15.2	
1981	99.7	118.9	-19.2	
1982	106.8	129.2	-22.4	
1983	114.4	140.3	-25.9	
DI Trust Fund:				
1975	7.9	8.7	-.8	7.3
1976	8.6	10.2	-1.6	5.7
1977	9.6	11.6	-2.0	3.7
1978	11.0	13.3	-2.3	1.4
1979	12.1	14.9	-2.8	
1980	13.0	16.4	-3.4	
1981	13.9	18.0	-4.1	
1982	14.9	19.6	-4.7	
1983	16.0	21.4	-5.4	

Note: The revised assumptions used for the estimates in this table are those of the Trustees' Report (plus the extension described in the note of table 1) modified as follows: (1) no change in the assumed rates of increase of earnings, and (2) the rate of increase in the CPI is 1 percent less than the rate of increase in earnings in 1976 and 2 percent less in subsequent years.

TABLE 3.—ESTIMATED PROGRESS OF OASDI TRUST FUNDS AFTER REVISION OF PROGRAM ACCORDING TO REVISED ASSUMPTIONS FROM THOSE IN 1975 TRUSTEES' REPORT

[In billions]

Calendar year	Total income	Total outgo	Net income	Fund at end of year
OASI trust fund:				
1975.....	\$58.6	\$60.8	-\$2.2	\$35.6
1976.....	69.6	68.7	+.9	36.5
1977.....	79.1	78.4	+.7	37.2
1978.....	88.1	88.5	+.4	36.8
1979.....	97.4	98.4	-1.0	35.8
1980.....	112.9	108.4	+4.5	40.3
1981.....	121.2	117.7	+3.5	43.8
1982.....	130.1	125.3	+4.8	48.6
1983.....	139.6	133.3	+6.3	54.9
DI trust fund:				
1975.....	7.9	8.7	-.8	7.3
1976.....	9.8	10.2	-.4	6.9
1977.....	11.1	11.6	-.5	6.4
1978.....	12.8	13.4	-.6	5.8
1979.....	14.3	14.9	-.6	5.2
1980.....	17.4	16.4	+1.0	6.2
1981.....	18.6	17.8	+.8	7.0
1982.....	19.8	19.0	+.8	7.8
1983.....	21.4	20.3	+1.1	8.9

Note: The revised assumptions used for the estimates in this table are those described in the note of table 2. The program would be revised by decoupling or restructuring the benefit computation procedures for benefits newly awarded and by increasing the combined employer-employee tax rate by 1 percent in 1976 and then by another 1 percent in 1980.

Mr. BURKE. In this assumption that you make here that differs a little from the official estimates, in 1979 the DI trust fund would be exhausted, and in 1980 the OASI trust fund. That doesn't give us time to postpone action, does it?

Mr. MYERS. I certainly agree with you on that, Mr. Chairman. I think that the time is due for action. As I said in my statement, I would certainly like to see it done so that it could be effective next year, and certainly no later than 1977.

I do believe very strongly that action should be taken this year, effective the beginning of next year.

Mr. PICKLE. Mr. Chairman.

Mr. BURKE. Mr. Pickle.

Mr. PICKLE. Didn't we have previous testimony presented to us that the administration felt that it need not have a tax until 1978?

Mr. BURKE. 1977.

Mr. PICKLE. Passage in 1977 to be effective in 1978.

Mr. JONES. No, effective in 1977.

Mr. BURKE. Pass it at any time, but don't have it effective until after November, 1976.

Mr. JONES. Mr. Chairman.

Mr. BURKE. Mr. Jones.

Mr. JONES. Mr. Chairman. I would like to ask a couple of questions of Mr. Myers.

Do I understand you correctly that you would be opposed to taking all the medical benefits out of the fund and funding that by general revenues?

Mr. MYERS. Yes, I would. I believe that the hospital insurance benefits, which are now financed on a wholly self-supporting basis except for a certain group aged 65 and over that was blanketed in when the system started, should on an ongoing basis be financed completely from payroll taxes, just as is now the case.

Mr. JONES. I have one other question. Your testimony confirms the belief in the traditional concept of social security. Yesterday one of my colleagues raised the question of adopting a new concept of social security, and that of insurance, whereby you would establish a floor and you would encourage people in private insurance funds and what have you, but if a private program didn't meet their needs for that floor in their retirement years that would trigger in the insurance from social security.

The theory was that you could establish a high floor and actually the program would be more sound. What do you think about changing the concept of social security and making the assurance that you hope you will never have to use it?

Mr. MYERS. I think that that approach is a very appealing one, but I do not believe that it would work in practice.

Mr. JONES. Why?

Mr. MYERS. The reason I say that is because if the provision of the basic floor of protection is left up to people's individual actions, the government would have to examine all different types of policies and plans and so forth. I think this would be tremendously complicated, and I don't think it would be administratively feasible.

Instead, I believe in keeping the provision of economic security separate, having a floor of protection through the government, and then having people build on top of it, either on their own or with the help of their employer.

Mr. JONES. Why would that be more complicated than an insurance company that sells health insurance and hopes nobody gets sick and collects?

Mr. MYERS. I think that a health insurance company hopes people will become sick and collect, but in accordance with the way it is estimated that they would do so.

Mr. JONES. I am not questioning insurance companies, but why is it more difficult?

Mr. MYERS. The reason I think it is more difficult is that I believe that people need this compulsory floor of protection coming from the government on which they can count and build. If they have to take individual, voluntary action, many of them won't do so; then, in a sense, this insurance that you refer to would be brought in in a great many cases.

Of course, I am biased, I suppose. I have been working along these lines of a governmental floor of protection for 40 years. I hope I don't have a closed mind, but I am convinced that this is the proper approach, namely having two separate tiers rather than trying to do it primarily from the private sector and with those who don't happen to do so then having financial support coming from the government.

Mr. JONES. Thank you, Mr. Chairman.

Mr. BURKE. Are there any further questions?

Mr. KARTH. Mr. Chairman.

Mr. BURKE. Mr. Karth.

Mr. KARTH. I assume your suggestion that the lower level benefits be increased slightly and the higher benefits level be decreased slightly is because those in the higher income groups can then probably purchase supplemental insurance, and those in the lower income

groups could not because their income would not allow them to afford it. Is that fairly close to accurate?

Mr. MYERS. Yes; I think that is a quite accurate interpretation of my views. In fact, that has been really one of the basic general principles of the social security system ever since it first began, namely that the benefits should be relatively higher for the low paid than for the high paid. The theory is that the higher paid can provide for themselves. It has also been this theory that resulted in having a maximum taxable earnings base; above that amount, people should be able to provide proper protection for themselves to ride on top of the floor of protection that comes from the social security program.

Mr. KARTH. That does, of course, accrue to the benefit of the insurance industry, and I am not making that as a malicious statement at all. It does obviously accrue to the benefit of the insurance industry.

Mr. MYERS. Yes.

Mr. KARTH. But you feel it also accrues to the benefit of the society in general, is that it?

Mr. MYERS. Yes. Basically, the reason I believe in this floor-of-protection concept is that it accrues to the benefit of society as a whole, and then incidentally it is advantageous to the insurance companies.

Mr. KARTH. I didn't mean to put words in your mouth.

Mr. MYERS. The insurance companies have been set up for this purpose of providing economic security for people. Of course, there are many other institutions similarly affected, such as the banks who are trustees for private pension plans; private pension plans that are self-administered; other savings organizations; investment companies; and institutions of that sort.

Mr. KARTH. Just one more question, Mr. Chairman.

As to the 10 percent benefit floor base that you talked about, I assume that you are recommending the 10 percent figure that you mentioned, is that right?

Mr. MYERS. That is right.

Mr. KARTH. Is that based upon 10 percent who are age 65 and over and drawing social security benefits, who need additional assistance, or is it based upon 10 percent of those people who are actually getting additional benefits? There is quite a distinction between those two.

I didn't really understand what your 10 percent benefits floor was based upon, which of those two concepts.

Mr. MYERS. I believe it is the first one that you mentioned. This criterion to determine whether the benefits are at a proper level to meet this floor-of-protection concept is that, if you consider all people over 65 who are drawing social security benefits, then against that total you measure what proportion in addition have to go to the government for supplemental help through public assistance. Then, if that proportion is small, such as 10 percent, I think that you can say that the benefit level is proper. Of course, this isn't a precise figure. If it was 9.9 percent it would be satisfactory, and if it was 10.1 percent you would not say that it was completely unsatisfactory. This measures the relative benefit adequacy.

Mr. KARTH. Of course I hesitate to interrupt, but the argument that enters into this criterion that you have established is that there are substantially greater numbers than the 10 percent who really need

it who can't get it. That is why I was wondering whether or not your 10 percent was based on those who need it, as opposed to those who are getting it. How do you establish this need?

This is a very theoretical thing. In the opinion of something like 20 or 25 percent they need additional benefits but don't get additional benefits. I was wondering where you drew the distinction, between those who are getting it or those who actually need it, or are getting it and the needs subject to considerable disagreement and debate.

Mr. MYERS. I am just assuming that everybody who needs public assistance would get it, because of the supplemental security income plan.

Mr. KARTH. Is the need based upon those who apply who say they need additional assistance even though they don't get it, or on what basis? That is kind of subjective, and I am trying to zero in on how this would actually work under the criterion that you laid out for us. I am not sure that I can calculate how it would work.

Mr. MYERS. I agree that this is more subjective than many other things we are dealing with in the social security program. I would assume that, with the national supplemental security income program, that the Committee on Ways and Means developed in 1972, anybody who really needs help can apply and get it under very definite mathematical criteria, and I was using that as a measure of need.

Other people might say that the standards in the SSI program are far too low and that many other people have needs. I have not really addressed that aspect of it.

Mr. KARTH. There are other benefits that enter into that need factor like food stamps, for example, and if anything should happen to either of those programs, or any program that lends additional assistance, I suppose there would then have to be an adjustment made in the social security benefits, would there not?

Mr. MYERS. Quite possibly. I think the various programs are all interrelated. It is the overall result of all the governmental programs that I think determines how well needs are met.

Mr. KARTH. Thank you.

Thank you, Mr. Chairman.

Mr. BURKE. Mr. Myers, I know you are familiar with the advisory council's report. Would you care to make any comments, or any observations on whether you agree with it or disagree with it?

Mr. MYERS. Yes. I would be very glad to.

Mr. BURKE. I know you referred to it a couple of times in your statement, but I thought you might like to amplify.

Mr. MYERS. As you know, I served as one of the actuarial consultants to the advisory council, so that naturally some of the things that they recommended are along the lines of some of the work I had done. I would quite obviously concur in those. I think that their general approach of decoupling, as it is called, which as you know is a very, very complicated thing, is a necessary basic step in remedying the financial difficulties that our social security system is facing, so that I am very much in favor of that.

I think that some of their other benefit recommendations were very good, such as the equal treatment of men and women under social security, although their recommendation was preempted by the Supreme Court deciding more or less that that should be done.

I also agree with their recommendation that coverage under the program should be universal, as much as possible, with all government employees being brought under it in one way or another, and also that any loopholes should be eliminated if they are not brought in.

On the other hand, where I disagree with the advisory council, and disagree rather strongly as I pointed out in this statement for the American Life Insurance Association, is on financing the hospital insurance system by a partial government subsidy in the immediate future, and eventually possibly having all the moneys for the hospital insurance system come out of general revenues, and at the same time moving the tax rate from the hospital insurance system over to OASDI. I think that indirectly this is a way of saying that you are going to have a government subsidy to the OASDI system. That is probably the major place where my testimony here would dissent from what the advisory council had recommended.

MR. BURKE. Do you care to make any comments on the trustees' report? Have you studied that?

MR. MYERS. Yes. I think the only comment that I would make on the trustees report is that which I indicated in my testimony. I think that they were a little too optimistic in their economic assumptions for the short-range cost estimates. As you are well aware, Mr. Chairman and members of the committee, the trustees agreed that there was a financial problem, and they only pointed out that it might be solved either by raising the tax rates or by raising the earnings base, or by a combination. The trustees did oppose a government subsidy and on that point my testimony agrees with the trustees.

Where my testimony disagrees with the trustees with regard to how to solve the financing problem is in regard to raising the maximum taxable earnings base to solve at least part of the financing problem. I would oppose that approach.

MR. BURKE. On that recommendation about universal coverage, don't you think it was somewhat vague on Federal workers as to how it could be brought about? I mean it is nice to be able to say we should have universal coverage, but then they leave it hanging out at the end of the branch.

MR. MYERS. I agree completely with you, Mr. Chairman.

The advisory council expressed the pious hope that this would be done, without saying quite how they would "put the bell around the cat's neck." As you well know, over the years this has been a very difficult problem for your committee, because almost all of the Federal employee groups have been completely opposed to being covered under social security. Therefore, there are great difficulties in accomplishing that result, even though in theory it might be the thing to do.

I think that the positive step that the advisory council recommended was the recommendation that, if such coverage could not be extended to governmental employees who were not under social security, then one loophole should be closed up; namely, the dependents benefits under OASDI should be offset when that dependent is receiving a governmental benefit based on her or his own earnings.

I think that a case might make this clear. Suppose we have here in Washington a woman who has worked her entire career in the Federal Civil Service, and her husband is also here in Washington working

in private industry. Under present law she would get a civil service retirement pension. He would get the OASDI benefit based on his own earnings record, and an OASDI wife's benefit would be paid on his earnings record. If that couple had both been working in private employment here in Washington, then a wife's benefit would not be paid, since each individual would receive his or her own social security benefit. So, there would seem to be elements of a windfall in this situation where one works for the government and one works in private industry.

The advisory council recommends, and I agree completely with them, that when the dependents' benefits are offset they should be offset not only by any social security benefit that the dependent was getting on his or her own earnings record but also by any other governmental employee pension benefits.

There is a precedent for this that was established in this very room by this committee in connection with the so-called Prouty amendment. When the benefits thereunder are paid to people over age 72 who were not eligible for social security on their earnings record, offset against them are any governmental employee benefits they receive. I think that this procedure would eliminate much of the problem arising out of the fact that there are the two separate systems, civil service retirement system and social security.

Mr. BURKE. Mr. Steiger.

Mr. STEIGER. Mr. Chairman, may I ask a question? If it has been asked, Bob, forgive me.

I have looked and looked, and I still don't understand the 10-percent final factor, and the 20-percent final factor. Can you help me understand what it is you are talking about?

Mr. MYERS. Unfortunately, there were two 10 percents that we have been talking about. The other 10-percent figure was a test of the adequacy of the system. In the benefit formula, both in the present one and in the new one that I am suggesting, a person's average earnings is first computed. Then, to this average are applied certain benefit factors or percentages. A higher percentage is applied to the first or lowest part of their average earnings because of the desire to give lower earnings people higher benefits.

The question is what benefit factor do you apply at the very extreme end of the average-earnings scale? At the present time, the maximum taxable earnings on a monthly basis is \$1,175, that is \$14,100 a year. As a practical matter, very few people could currently and in the near future have an average monthly earnings in excess of \$900 under this wage-indexing or decoupling system that I am proposing. The question is what new benefit formula can we develop to apply to these average earnings that will fit the results under the present formula.

I have developed this formula of 100 percent of the first \$134 of average indexed monthly earnings, plus 29 percent of the next \$766, and that very closely duplicates what the present law does.

Then we are left with the question of what factor should be applied to the very highest earnings? This is a theoretical matter to some extent, because it won't be for a number of years that many people will get into that range.

I selected a 10-percent factor as the final or end one. When I first thought about it, I used a 20-percent factor. On thinking it through more fully, I decided that a 10-percent factor was better, because, over the long range, for the man with the highest earnings that are possible, using this 10-percent factor would give him a benefit ratio of about 33 percent of his final earnings. This seems to be a reasonable relationship, because this is just what, by chance, has prevailed under the present method for the past 20 or 25 years.

Mr. STEIGER. If instead of 10 percent you took your original 20 percent, where does that put you?

Mr. MYERS. That would be applicable to very few people initially, and not to too many ultimately, and would give a benefit ratio of around 35 to 36 percent. The 10-percent factor would give around 33 percent. It just seemed to me that the latter is a reasonable relationship for the very highest paid people who are covered under the system.

Mr. KARTH. Would the gentleman yield?

Mr. STEIGER. Yes.

Mr. KARTH. If you didn't apply some kind of new formula such as you have applied, eventually in the not too distant future many people would be drawing greater benefits under the social security than their wages were during their productive lifetime, isn't that true?

Mr. MYERS. That is correct. That is exactly why the decoupling or restructuring is needed.

Mr. STEIGER. Can he do one other thing for me, Mr. Chairman. We had yesterday a Ralph Nader group, public citizens tax reform research group and a number of others. By and large the thrust of their suggestion on how to deal with short term and long term is to simply increase the base against which whatever rate it is is applied. You are saying here, and my own totally ignorant view has been that if you do that do you not then have a situation in which the individual who retires and has had the tax applied against a \$25,000 base retires with an extraordinarily high retirement benefit which conceivably is in excess of that which he in fact paid in. Is that accurate, or inaccurate?

Mr. MYERS. What you have said is quite accurate for the present older workers. For example, if a man is 65 years old now, and this is his last year of employment, and if the base today were \$24,000 instead of \$14,100, he would get a windfall. He would pay about \$580 more in taxes, and the additional benefits that he would get would have a value of around \$2,000.

Of course, the younger person who is paying OASDI taxes all his life will get larger benefits, but they will have a value which at most will be about the equivalent of what he pays. However, his employer's tax will help to finance the system.

There is a limit to how much raising the earnings base can do. If you eliminate the earnings base completely and tax all earned income, this could not solve much of the financing problem of the system. It would solve some of the short-range difficulty, but it would solve less than 20 percent of the deficiency. Such action would produce the equivalent of only about 1 percent of taxable payroll, whereas the deficiency is over 5 percent of taxable payroll.

Mr. STEIGER. Thank you, Mr. Chairman.

Mr. BURKE. Mr. Waggoner.

Mr. WAGGONNER. Thank you, Mr. Chairman.

Bob, we are glad to have you back again.

Mr. MYERS. Thank you.

Mr. WAGGONNER. The last time you were here, you and I discussed very briefly the relative merits of automatic increases based upon the CPI and what Congress had done to jeopardize that which might succeed in the way of automatic increases by not allowing it to go into effect, and by congressional action mandating increases which were far in excess of what the CPI itself would have provided had those increases been allowed to go into effect before now, which they have done with this month I guess because they show on next month's checks, don't they?

Mr. MYERS. That is correct.

Mr. WAGGONNER. You made a point initially in your statement that the Government through social security and compulsory social security should, in your opinion, provide a floor. It seems to me that most people are approaching it from the point of view now that a floor is not what they are interested in, that we ought to be interested in total sufficiency of the needs of the beneficiaries through social security.

Nobody has said what you have about the utilization of the supplemental security income program the way you have. How can we provide through supplemental security these additional benefits where those benefits are necessary without doing to supplemental security what we already have apparently done to social security and letting that get to be such an expensive program.

Mr. MYERS. I think there is no automatic and simple answer to this question. I think it is up to the deliberations of Congress over the years to keep examining the relative size of the SSI program as it relates to the social security program, and to see that people's needs are adequately met without at the same time stifling economic security provisions through the private sector. At the same time, I think you have the problem of keeping supplemental security income within bounds, because if it gets to be too high it can destroy social security.

Mr. WAGGONNER. All right. Now, I will skip over your second tier which was the private sector. If we err in either of these respects with regard to the first tier or the third tier, isn't it inevitable that we destroy the private pension system?

Mr. MYERS. Yes.

Mr. WAGGONNER. It seems to me that that is something else that we have to face up to.

In providing for automatic increases related to CPI, it was envisioned, and we erred again in judgment, or at least in my opinion we did, because we envisioned financing the CPI increases by raising on a schedule the wage base, the taxable wage base. Is it as obvious to you, as it seems to be obvious to me, that here is our great deficiency, increasing the base at least on the schedule that we thought would work is totally insufficient? Am I wrong or right?

Mr. MYERS. You are correct, as it has worked out in recent experience. As you know, during the 1950's and 1960's that procedure as it was followed on an ad hoc basis worked out beautifully.

Mr. WAGGONNER. If we can accelerate that wage base to be taxed, the rate of taxing the wage base, by increasing the wage base beyond

what we visualize, what is the effect of that? What inequity does that provide?

Mr. MYERS. I think that it provides inequities if it is done too rapidly. If the base is jumped sharply in 1 year, it creates windfalls for older high-paid people. More importantly than that is that if the earnings base is increased very greatly over the present level, whether in steps over a period of years or suddenly, this is undesirable. Such procedure raises the scope of the program so that it provides more economic security for people in the highest income levels and therefore leaves less responsibility on those individuals themselves and on the private sector to do what they can and should do.

Mr. WAGGONNER. You raise the benefits with a group of people who are already criticized for getting favorable treatment because earned income is treated in a different way than unearned income. Tax, of course, is not applied in any way to unearned income, investment income, and that type of thing.

Mr. MYERS. Yes, you are correct.

Mr. WAGGONNER. Yesterday we had before us a couple of gentlemen, one of whom apparently was from the insurance sector which you represent today, representing 378 insurance companies with Inter-American Life Insurance Association. Having already talked about deficit financing provided for with an escalation of the wage base, if we can devise a formula which produces an increase in benefits related to the CPI, what is the wisdom—or can it be done at all—of abandoning an escalation of the wage base to finance increases in benefits and writing a formula which would provide financing by escalating the tax rate? Can that be done?

Mr. MYERS. I suppose that technically this could be done.

Mr. WAGGONNER. Would it be more expensive than people want to pay?

Mr. MYERS. I think that what I would say in arguing on the other side of this proposal is that I believe the base should be escalated only in the sense that it keeps up with changes in the general level of earnings. It shouldn't be escalated relatively more than earnings. If the base were to be left absolutely constant in dollars, I think that this would not recognize the economic facts of life. As you well know, the dollar is not the same today as it will be 20 years from now.

Mr. WAGGONNER. Are you saying continue to escalate the wage base, but escalate at a more rapid rate than we had planned, a tax rate?

Mr. MYERS. No, what I recommend is that the base should be escalated only under the automatic-adjustment provisions that are now in the law. In other words, it should increase only at the same rate as wages themselves increase, and any increased financing necessary, either for the deficiency or the rising cost of the system, should be met on a straightforward open basis by tax rates that are visible to all and applicable to all.

Mr. WAGGONNER. But you are saying increase the tax rate?

Mr. MYERS. Yes.

Mr. WAGGONNER. All right. You came down hard on one other aspect. I want to be sure that you mean this. You mean not even in the interim should we provide anything in the way of an input of cash to entirely help solve the short-range problem?

Mr. MYERS. That is correct. I do not believe in either a permanent arrangement for a Government subsidy, such as one-third of the total cost, nor do I believe in a stopgap measure such as putting, say, \$6 billion into the trust fund this year to keep it from decreasing, but then stating that "we will never do it again."

Mr. WAGGONNER. Thank you, Mr. Chairman.

Mr. JONES. Will the gentleman yield?

Mr. BURKE. Mr. Karth.

Mr. WAGGONNER. Mr. Jones asked me to yield, and then I am through.

Mr. BURKE. Excuse me, Mr. Jones.

Mr. JONES. If you took out the dependents who have government pensions from the system today, how much would that save? Do you have any idea?

Mr. MYERS. My proposal was a long-range one. I would never take benefits away from people who are getting them today, but rather I would make it so that this couldn't happen in the future. This would not be a great cost saving matter that would remedy all the financial problems of the system. It seems to me that such a change is desirable and necessary from the standpoint of equity as between different citizens.

Mr. JONES. I was curious if it were done today and were not applicable today how much less would we pay out? Do you know?

Mr. MYERS. I haven't made any calculation of this. I would guess that it would be somewhere in the neighborhood of \$50 million a year in the first few years but is a growing amount over the years.

Mr. KARTH. Mr. Chairman.

Mr. Myers, you suggest that we at the most increase the rate in proportion to the increased income, but not beyond that. On the other hand, you recommend that we don't go beyond the \$14,100. There is some inconsistency there. Maybe I didn't understand you correctly. Would you enlighten me as to what you really mean?

Mr. MYERS. What I meant was that the present \$14,100 base should not be increased in the future any more than the automatic adjustment provisions in present law will do.

Mr. KARTH. You mean we should expand that?

Mr. MYERS. That amount should be increased in the future as wages rise, but only to the extent that wages rise. In other words, if wages were to rise 8 percent, I would let present law operate and increase the base by 8 percent, but I would not increase it beyond that.

Mr. KARTH. One other question, Mr. Chairman. This is I guess somewhat related to the dialog we just had. You said we cannot go beyond a certain point with the tax rate, and if we do it would be self-defeating. What is that maximum tax rate that you would suggest we cannot go beyond, and if we do it would have a self-destruct feature to the social security system?

Mr. MYERS. I am sorry, but I don't believe I ever said that.

Mr. KARTH. I thought you just said in your colloquy with Mr. Waggonner, and I think it was Mr. Waggonner, that the tax rate should not go beyond a certain point because if it does it would defeat for all practical purposes what we are intending to do in the social security system. I am trying to explore as to what you think that maximum tax rate should be because in your paper you suggest that

it go to 6.58 percent on the employee and employer by 1983, a half percent now, and another half percent in the early 1980's. That takes us to 6.58 percent on both the employer and employee. You recommend another half percent some decades down the road before the year 2000, so that we are now up to a total of 14.5 percent. What percent do you think it should not go beyond, and if it does it reaches the self-defeating of the purpose for which social security was intended?

Mr. MYERS. I hope I didn't say that.

Mr. KARTH. Let's say that you didn't say it. Would you say that?

Mr. MYERS. I would not say that there is any maximum possible tax rate. I prefer to look at it from the other side and say that as long as you have a benefit level that is reasonable and that is at the floor protection level, you don't need to be concerned about the tax rate rising too high.

I remember that about 12 or 13 years ago, there was a lot of discussion in this country that 10 percent for the employer and employee combined was the absolute maximum rate you could levy. There was an interesting colloquy about that between the late Senator Byrd and Senator Ribicoff, who was then Secretary of HEW.

Mr. KARTH. Whom did you agree with at that time? They both agreed that 10 percent was the absolute maximum.

Mr. MYERS. No, I didn't agree—of course I didn't publicly disagree—because I think that you cannot pick an arbitrary figure such as this. You cannot say that a 9.9 percent tax rate is fine and that a 10.1 percent tax rate is catastrophic. Obviously if you get a 40 percent tax rate that would be pretty bad.

Mr. KARTH. Where between 14 and 30 percent, in your own good wisdom and solid businesslike judgment, would you decide the figure was at a figure beyond which we could not go?

Mr. MYERS. I don't think we can pick any one precise figure.

Mr. KARTH. I thought you had made that statement. We will check the record.

Mr. MYERS. If I did, I certainly didn't mean to, because I always want to look at the benefit side, and as an actuary say, if you fix the benefits, the rate will come out at what it should be.

Mr. BURKE. Mr. Myers, in your experience as an actuary, did you ever have a breakdown of that portion of the social security that is devoted to welfare, and an estimate of approximately how much it costs?

Mr. MYERS. Mr. Chairman, when you are referring to welfare, do you mean what proportion of the benefits that people have paid for themselves by their social security taxes as against what proportion they didn't, which were in a sense a welfare gift?

Mr. BURKE. Yes.

Mr. MYERS. I have made a number of calculations on this subject over the years. The result, of course, differs very greatly as between generations. For people retiring in 1940, 99 percent or so of their payments was welfare in that sense. For people currently retiring, probably about 80 percent of their benefits is welfare. People retiring many years hence will, at some point, be paying for all their benefit, and there won't be any welfare to it.

It is very difficult to derive one single figure and say that that certain proportion of the whole program is welfare, with the remainder being paid for as individual equity insurance.

Mr. BURKE. We have those people who keep referring to the social security program as an insurance program, strictly an insurance program, and we know from the minimum benefit payments and dependents' and survivors' payments that there are other areas in social security that go a little beyond the insurance aspects of it.

The thing that bothers me is why there is such strong feeling against using general revenues to relieve the situation. I wonder why the public expects the social security to carry this load in its entirety with no help whatsoever from general revenue?

Mr. MYERS. I think that, by their having actually made earmarked contributions or taxes and their employer doing the same, many people tend to feel—and certainly sometimes far too much so—that they are actually paying for these benefits just as they would if they went to an insurance company.

My main reason for being opposed to general revenues financing is that I think it tends to make the cost picture rather unclear. It tends to deceive people into thinking that somebody else is paying for their benefits, and that the money coming from general revenues is coming from an entirely third party. As I see it, general revenues is derived by taxes on the entire population, and so to a large extent they fall back on the same people who pay the payroll taxes.

Mr. BURKE. I look at it a little differently than you do. I look at it from the side of the social security trust fund that is paying some bills that should be assumed on a general basis out of general revenue. In fact, you take medicare. I know one large city last year that was reimbursed \$17 million in medicare. When medicare wasn't in existence the property owners of that city would have had to get up that \$17 million to pay the bills of those people who never had the money. They have been relieved of all those responsibilities throughout the entire country in local, municipal, and county hospitals, and relieved of the burden that they carried before. Yet everybody seems to think that the social security trust fund should carry all these burdens and relieve the people from the burdens, and that there is no justification for looking at general revenues.

How is it looked upon in countries where they have a one-third-one-third-one-third basis?

Mr. MYERS. As you know, Mr. Chairman, there are a number of countries that do have that basis. There are also countries that operate countries that do have that basis. There are also countries that operate the way we do, where the system is completely self-supporting from payroll taxes. In fact, there are all sorts of mixes in this matter of financing. Some countries put in only a little general revenues, others go up to as much as a third, and there are some countries where about half the cost comes out of general revenues.

Mr. BURKE. I am a little upset too when I look over the figures since the inception of social security and see those beautiful loans that the Government enjoyed at very low rates of interest from the social security trust fund. I don't think that insurance companies would like to loan out money at those low rates. They would never be able to pay off their beneficiaries if they engaged in that type of practice.

Mr. MYERS. As I see it that is an investment problem. I bought a bond during World War II which I still have. It pays an interest rate of only, as I recall, 2.75 percent. The Government is not going to pay that bond off for me until it is due in the 1990's. I would like them to pay me \$1,000 now so that I could reinvest at 8 percent.

Mr. BURKE. You don't mind making a patriotic contribution during the time of World War II, but after World War II was over it seems to be a little unfair to have those practices continue the way they did. It is only through the pressure on the part of this committee under our chairman that the Government was forced to pay the going interest rate to the trust funds.

As an expert in this field you must realize that no fund could ever continue to exist paying out those low rates of interest with the escalation in the cost of living and the devaluation of the dollar, and all the other things that have happened.

For those reasons I happen to be one of those people who believe that the Federal Government has a moral responsibility to replace some of those funds which were not paid when they took advantage of the trust fund over the years to help get the trust fund in a stable condition. I guess we are going to have difficulty getting some people to live up to their moral responsibilities in this country.

Mr. MYERS. I certainly agree with you, Mr. Chairman. One of the many great contributions that this committee has made over the years was in revising and making more equitable the investment basis for the Government bonds that the trust funds buy. As you may know, I was cheering the committee along at the time it made these changes.

Mr. BURKE. You have been an excellent witness over the years, Mr. Myers. I would rather accept your advice and counsel and sometimes go along with your recommendations because you are not an optimist. I don't want to say you are a pessimist.

• Mr. COTTER. He is a realist.

Mr. BURKE. You are a realist. Let's put it that way. The committee appreciates it.

Mr. MYERS. Thank you, Mr. Chairman.

Mr. KARTH. Mr. Chairman. May I ask one more question. I am not sure that I understand yet the philosophy that Mr. Myers is exposing us to.

No. 1, if I understand you correctly, when you were having the colloquy, you said you do in fact recommend increasing the base in proportion to the increased income. Since the income has gone up since we established the \$14,100 base, and certainly since the income will go up between now and 1983 and 1984 when you recommend a 1 percent increase, why have you then not proposed that during that period of time we increase the base? You have not according to the testimony that I have read. I tried to follow you very closely. Shouldn't you have recommended an increase in the \$14,100 base?

Let's say it goes up 16 percent during the next 8 years from the time we established the \$14,100 to 1985. That is \$22,000 plus. Yet you don't recommend we do that in your statement. How do you square that with what you told me?

Mr. MYERS. I think that indirectly I did recommend this. I recommended that, as far as the earnings base is concerned, you should continue present law, which says that there will be automatic adjustments of the earnings base when earnings rise. So this was, therefore, built into my recommendation.

Mr. KARTH. So, you are recommending—

Mr. MYERS. That present law be retained and allowed to operate in increasing the maximum taxable earnings base as the general level of wages rises.

Mr. KARTH [continuing]. That if the standard goes up to \$22,500 by 1985 that we increase the base to \$22,800?

Mr. MYERS. If wages are 50 percent higher in 1983 than now, then the base should be 50 percent higher, or something around \$21,000. In other words, let present law operate just the way it is, and don't take ad hoc action to increase the base more than the automatic adjustments would do.

Mr. KARTH. I wasn't sure your statement explained that.

Mr. MYERS. That is what I meant.

Mr. BURKE. Thank you, Mr. Myers. The committee appreciates your appearance.

Mr. MYERS. Thank you, Mr. Chairman.

Mr. BURKE. Our next witness is Mr. Charles B. Hobbs.

You may identify yourself and proceed with your testimony.

STATEMENT OF CHARLES B. HOBBS, ECONOMIC CONSULTANT

Mr. HOBBS. Thank you.

Mr. Chairman, and distinguished members of the subcommittee, my name is Charles Hobbs; I am an independent public policy consultant with 20 years experience in the design, operation, management, and evaluation of Government programs. For the past 6 years most of my time has been devoted to analyzing the effects of the social reform programs enacted by the Federal Government since 1935.

I appreciate your invitation to express my views on the short-term problems of financing social security. I hope that my comments as to the nature and causes of those problems will add perspective to other testimony you have received or will receive.

It is difficult to be neutral about social security, and I do not pretend to be. My view on the futility of funding unexpected short-term excess expenditures by traditional methods stems from a firmly held opinion that social security as it is presently structured, is unfair and unnecessarily costly to both active and retired workers; and my belief that, if the future continues the past, social security will become more unfair and more costly until it collapses under its own weight, thus depriving America's workers of much of the retirement income they have been led to expect. The longer the system continues to operate in its present form, the harder it will be to prevent its collapse, and the worse will be the impact.

Social security is not an unsound system because it is going broke; rather it is going broke because it has become unsound. These are its major fiscal defects:

1. Unlike private insurance benefits, social security benefit levels are determined politically—by vote of the Congress. As a result benefits have been increased over and over again without regard to future ability to fund those benefits. Thus, the social security trust fund, once intended to grow until the benefit obligations were fully funded has, in the face of increasing benefits, rapidly dwindled to a cash-flow account, and at the current rate of spending and income will run out of money according to the Social Security Administration by 1981.

I agree with Mr. Myers that that is a very optimistic estimate by the Social Security Administration.

Payroll taxes paid into social security are presently paid out in benefits within less than a year. Present commitments extend over the next 75 years and total more than \$4 trillion, producing a present value actuarial deficit that is probably greater than our current GNP.

To justify this strange and apparently self-defeating method of managing public funds those who defend social security have attempted to rewrite history to make the public believe that social security is social insurance not subject to normal fiduciary constraints.

2. The second major defect is that social security decreases investment potential within the economy by draining off large amounts of money that, in a cash-flow system, cannot be invested for return. A recent economic analysis shows that social security has reduced total private savings—and hence investment in the American economy—by about 38 percent. This has caused a reduction of \$120 billion in the current GNP, a 15-percent depression of wage rates, and a 28-percent inflation of interest rates. By far the greatest impact of this smothering of the economy is on middle- and low-income workers, who are forced to give up to ever-increasing social security taxes money they would otherwise put into savings or other investments.

I might point out here that an average family income manages to keep pace very nicely with the social security base for tax purposes. However the median income of families in the United States is considerably below that average income which means we have more than 50 percent of the families bearing their load below the base of the social security tax.

It is obvious that these problems of the social security system are independent of any distinction between short-term and long-term. It is equally obvious that the longer the system continues to operate in its present form the worse these problems will become and the greater will be the impact of the system's collapse upon people who expect to receive its benefits.

I fear that the method most likely to be adopted to save social security, if not in the short term then certainly in the long term, is the gradual infusion of general revenue funds into the system until social security merges with and becomes welfare. This is the solution favored most by a large number of welfare professionals in HEW and, upon examination of the progress through bankruptcy of a trust-fund oriented social security system, it is clear that time is on their side.

When Social Security Administration Commissioner James B. Cardwell testified to the House Select Committee on Aging, on May 5, 1975, he said that he "personally would not like to see the use of general revenue funds" to "replenish the trust funds." Elsewhere in his testimony he indicated that "By 1981, unless additional revenues are forthcoming, the reserves will be exhausted." And still elsewhere, "There is good reason, in fact, to rely on the reserves during the next several years, to aid economic recovery." That last statement sounds reassuring, and I would certainly agree that a \$55 billion continuing balance in the trust fund is an unnecessary usurpation of money that otherwise could be used by low- and middle-income workers to ease the problems of the recession. However, draining the trust fund without a restructuring of social security to prevent its merger with welfare will leave the Congress with a Hobson's choice in 1981. With the reserves gone the Congress will have to choose among the following alternatives:

1. An increase in the social security tax rate, which will further increase the burden of the system on lower and middle-income workers.

2. An increase in the rate at which the taxable income base for social security rises. It now rises with the cost of living and will be close to \$20,000 by 1981. I had not read the trustees report when I brought that and now realize that will be closer to \$22,000.

3. A cutback in the benefits paid from social security, or the adjustment of the rate of benefit increases to wages instead of prices which, to an individual or couple trying to live on social security income alone, amounts to the same thing.

4. The use of general revenue funds, which can be deficit spent and therefore not be reflected in immediate tax increases or perceived cuts in benefits.

Given the fact that Federal and State governments have not once in the past 15 years been able to reduce the benefits of social security or any other social reform program, and given further the widespread dissatisfaction, especially among young workers, with rapidly increasing social security taxes, it seems evident that the choice would really be either general revenues or nothing.

Two other problems affecting the impact of social security on America's active and retired workers must, in my opinion, be addressed right along with the deficit in any short-term solutions. Commissioner Cardwell touched upon them in his previously mentioned testimony, but in ways which I feel are extremely misleading. The first problem is the income test which unfairly discriminates against retired workers who wish to continue working at least part time. In his testimony Commissioner Cardwell said, "Benefits are wage related and paid as an earned right; there is no means test." In fact benefits are reduced \$1 for every \$2 earned above \$2,520, currently, in any year by a retired worker who has not reached the age of 72. This income test, which is certainly a form of means test, has been justified by one of the apologists for social security as the best means "of accomplishing the basic aim of the program, that of taking older people out of the labor market."

It cannot help but have that effect since it forces people not to work from the time they retire until they turn 72. After 7 to 10 years of not working, it is, of course, virtually impossible to reenter the labor market, particularly when you are 72 years old.

This income test, which the Commissioner does not wish to admit is a means test, is one of the most offensive and debilitating features of social security and should be dropped as a part of any modification to the social security system.

I might insert here that a couple of years ago then Commissioner Ball testified that there would be about 1.5 million people affected and it would cost \$4 billion to the program to eliminate this means test. Just a simple calculation shows that those 1.5 million people would each be receiving less than the average per individual, which is around \$165 to \$175, so that something is wrong with the figures there.

The second additional problem which must be addressed is the loss of earnings to low and middle income workers and their families due to regressive social security taxes. I am here defining "regressive" to mean that lower income workers are forced to pay a greater percentage of their income than are higher income workers. I know several economists who claim that social security taxes are not regressive,

or at worst are merely an offset to the progressivity of the personal income tax. I doubt whether most of them have tried to live on incomes equal to or less than the taxable base income for social security in the last few years. If they had they would undoubtedly know from experience that the practical effect of social security taxes is to eliminate any discretionary spending by lower and middle income workers. Ironically, Commissioner Cardwell characterizes social security as being "essentially insurance against loss of earnings" when in fact, social security is the principal reason a low- or middle-income worker is unable to put aside for himself any money to meet emergencies or provide for his own retirement income. Being forced to pay off the top all of the money one might have used to increase his chances of future financial independence, and to pay it into an obviously troubled system where the only assurance of return is in the promises of politicians and bureaucrats, is an unacceptable condition to a growing number of American workers. Social security must be revamped to remove the unequal burden placed on low- and middle-income workers, but without decreasing the investment potential of the entire economy. This can only be done, in my opinion, by a complete restructuring of social security that will maximize the investment value of moneys now being wasted in a non-interest-bearing cash-flow system.

Clearly, I do not believe you can dissociate the short-term financing problems of social security from the short- and long-term deficiencies in the system which make it unfair and unnecessarily expensive today, and which at some point, in my opinion, will cause it to collapse. It is my opinion that no legislation covering short-term solutions should be considered except as a part of a general restructuring of the system that will restore equity, expand individual choice, and prevent the mechanism for providing workers' retirement security from absorbing or being absorbed by welfare. The greatest danger lies in the dilution of the incentive to work that would be produced by a marriage of social security and welfare and yet, as I have pointed out, this course could be virtually forced upon the Congress if it does not restructure social security in the next few years.

Mr. BURKE. Thank you, Mr. Hobbs.

Mr. Cotter.

Mr. COTTER. Thank you very much, Mr. Chairman.

Mr. Hobbs, what is your recommendation then? You mention a restructuring of the whole system along what lines?

Mr. HOBBS. As it mentions on the front, I am the author of a monograph on restructuring social security. It is my understanding that this set of hearings was devoted to short-term problems and not to long-term restructuring. However, I would be glad to go through that proposal, and I have copies that I can leave with you.

Mr. COTTER. As far as the financing of the system on a short-term basis, what would you recommend?

Mr. HOBBS. As I say here, I don't believe that a short-term financing could be divorced from a long-term, and within the next 2 years the system should be totally restructured. I didn't think that immediate action needs to be taken apart from long-term restructuring.

Mr. COTTER. What would you do as far as long-term financing?

Mr. HOBBS. Long-term financing, I would first of all eliminate the payroll tax entirely, and second, return that money in the form of an

increase, pay increase to the workers of the United States amounting to what they are presently paying in taxes and what their employers are presently paying in taxes. I would then require on the part of the Federal Government that each worker in the United States provide for his own retirement income through one of the following two methods: Either by investing 10 percent of his earned income or \$2,500 a year, whichever is less, in current or constant dollars, over a period of time, but in dollars today I am talking about, into a private pension fund that is set up under the Pension Reform Act of last year, or alternatively invest that money in U.S. retirement bonds, which would be structured somewhat differently from the present bonds to grow at the highest of three rates. One would be the rate of the Consumer Price Index. The second would be the rate of the money gross national product, and the third the interest rate on current short-term notes of the Federal Government.

I believe that that pretty much outlines what I have in mind.

Mr. JONES. Would the gentleman yield?

Mr. COTTER. Yes; I yield.

Mr. JONES. How would you finance the current recipients of social security until all of those people are gone?

Mr. HOBBS. I firmly believe that it is time to recognize that we have incurred a tremendous debt through the social security system to people who are presently retired and people who are presently working roughly over the age of 40 who will get back much more than they put into the system. We must recognize this debt in my opinion openly and must finance it in the way that is most appropriate to the country.

That means to me that we should finance it first of all through the sale of those U.S. retirement bonds to the extent that they can be financed that way, and the amount that is left over which I would say was sizable would be financed through increases in personal income taxes.

Mr. JONES. I thank the gentleman.

Mr. COTTER. You mention in the first page here that in your opinion social security as presently structured is unfair and unnecessarily costly to both active and retired workers. My God, retired workers are getting considerably more in return than they ever contributed.

Mr. HOBBS. Some are. That is true. In view of the rapid rise in cost of living and the feature of the income test in the social security law, a person who, let's say, retires at 65 and just as an example has been relatively well off during his working career, and let's say ended up with a salary of somewhere in the neighborhood of \$20,000 to \$25,000 as a construction man, retires and suddenly finds that if he were to continue working he would have his benefits drastically reduced. He couldn't possibly make half as much by working, because the reduction in social security benefits. Either he disregards the social security payments entirely or gets back nothing of what he has put into the system until he turns 72, or else settles for roughly one-third or a quarter of his active working income in retirement and at the the same time is forced into a sedentary existence.

I feel that this is an unfair system in that respect. I would submit that with the average life expectancy of American males at somewhere around 72, this is an ironic feature that 72 is the cutoff point.

At the age that you are supposed to die they will let you go out and work after 7 years of not being able to work without reducing substantially or completely your payments.

I realize that \$2,520 is excluded this year, but that is peanuts when you are talking about somebody who has been working at substantially more than that and also contributing to the system. It is not a contribution at all. It is a forced tax.

I think it is unfair in that regard because there is no choice either on the part of the active worker or on the part of the person who is retired as to how his benefits are to be received, or how his pension program is to be set up. For those workers who make less than the average income in the United States virtually all of their savable income is drained off in social security taxes right now, and obviously from the proposals we have heard from the Social Security Administration and Mr. Myers' proposal, we are talking about raising those taxes even higher.

Mr. COTTER. To sum it up, you are basically opposed to the whole system and would create a new system such as a retirement plan where people are required to deposit a certain amount of their salary into the fund.

Mr. KARTH. Would the gentleman yield?

Mr. COTTER. Certainly.

Mr. KARTH. A voluntary retirement plan?

Mr. HOBBS. No. I am for retaining the compulsory requirement on the part of the Federal Government that people provide for their retirement income, but also feel that that can be done and give people a choice at the same time whether they invest in U.S. retirement bonds which cannot be manipulated in the way that the social security system has been over the years, or alternatively to invest in private pension group plans.

Mr. COTTER. I have nothing further, Mr. Chairman.

Mr. BURKE. Are there any further questions?

Mr. JONES. What would your proposal do to private insurance agencies?

Mr. HOBBS. Well, it won't underwrite them as Mr. Myers' proposal would. I think that the insurance industry, like most industries in the United States is as buried by Federal regulation as they can tolerate. I certainly understand their attempting to defray the risks of insuring people to make sure that the Government takes care of those people who might be higher risk.

In restructuring the system I believe that the insurance industry should stand on its own feet. If they can provide pension programs that will surpass investment potential and returns social security as I feel they can, then they should be able to do that. If not, we will certainly know within a few years, and we can return to the present mess.

Mr. BURKE. Mr. Pickle.

Mr. PICKLE. Thank you, Mr. Chairman.

I was not here for all your testimony, so that I may be retreading some ground. You make two points right at the beginning. One, you said that social security benefits unlike private insurance benefits are unrealistic inasmuch as the benefits are voted by Congress. Are you recommending that the Congress not set the benefits, that we have nothing to do with it?

Mr. HOBBS. That is right. In the long-term restructuring I am suggesting that the Government involvement in terms of the issuance of U.S. retirement bonds to people and also in the insurance in the same way that the FDIC insures banks as the Government is supposed to be insuring the pension industry through the recent Pension Requirements Act in the Government underwriting of private funds. But that the Government itself not be involved in the structuring of benefits that go to people or in the setting of taxes that people pay, aside from setting a maximum amount of money that can be invested in U.S. retirement bonds every year.

Mr. PICKLE. I guess you have answered the second question I had, and that is that you point out that social security drains off a lot of the cash flow from society that can be reinvested.

Mr. HOBBS. Yes, sir.

Mr. PICKLE. So that you would not have the Government actually passing the taxes or collecting the money?

Mr. HOBBS. That is correct.

Mr. PICKLE. In both instances you just go to the retirement system, or retirement program, that you would recommend through restructuring?

Mr. HOBBS. That is right. Again, the Government would be issuing bonds and redeeming bonds as it presently does, and I will leave copies of my monograph with you, if you would like. The bonds that I have suggested would grow at a rate that would guarantee that anybody investing in those bonds would have his returns geared to the economy of the United States, not just to the Consumer Price Index, but if the gross national product rose faster than the CPI in a given year, if we had productivity for a change, there would be a faster increase in the value of those bonds. If they never grew rapidly but the short-term notes drew a higher interest rate it would be the return on those notes.

Mr. PICKLE. Have you talked to Congressman Udall about this?

Mr. HOBBS. No.

Mr. PICKLE. It seems ready made for him, election laws, postal laws. Let him know about that.

Mr. BURKE. Are there further questions?

Mr. KARTH. Mr. Chairman.

Just one observation, and I want to see if the witness agrees.

I am not here to benefit the insurance companies any more than I am the economic consultants. It seems to me that if everyone had this freedom of choice to invest these funds would it not accrue to the benefit of the economic consultants who would charge for their advice?

Mr. HOBBS. Not to me. That is not my business.

Mr. KARTH. How about the profession as a whole?

Mr. HOBBS. I think it would accrue to the benefit of the economic consultants who are associated with private pension programs, and that is the insurance industry in a large part.

Mr. KARTH. But not necessarily just the insurance industry?

Mr. HOBBS. Well, those are certainly the people who know the most about pension programs and their returns.

Mr. KARTH. Are you suggesting as an independent economic consultant that you don't really know much about the investment of private funds for purposes of returning annuities?

Mr. HOBBS. I am certain that I don't know as much about the details of any given pension program as the people who work in it, in the same sense, and I think this is an interesting point, that no one can possibly know as much about the data involved in social security as the Social Security Administration. I have yet to see what I would consider to be a complete set of assumptions provided to the Congress or provided to the public about how the Social Security Administration makes its computations, how, for instance, they arrive in their latest trustees' report at a 2-percent difference between the growth in wages and the growth through inflation.

Mr. KARTH. That is all, Mr. Chairman. Thank you.

Mr. BURKE. Mr. Jones.

Mr. JONES. I have just one question, Mr. Chairman.

Under your plan what would you do with disability?

Mr. HOBBS. I would incorporate disability as a rider to the bond program itself. In other words, the bond program would provide an annuity at age 65, or it would provide an annuity to a disabled person when he became disabled. I would incorporate the disability features. I would not incorporate the health insurance or medicare features in such a program. I agree there very much with Mr. Myers that the danger of going to a general funding of the medicare program or the hospital portion is acute, and if you divorce the entire medical care program from social security I feel you can address it in general fund terms, otherwise we are back to playing the same game of benefiting some people at the expense of others, whether or not they work.

Mr. JONES. I would appreciate it if your monograph would be included as part of the record if you furnish it to us.

Mr. HOBBS. I had limited space to bring them, so that I only have a few.

Mr. BURKE. That is your monograph?

Mr. HOBBS. Yes.

Mr. BURKE. If you leave them we will give them to the staff to study.

Mr. HOBBS. I can get more if necessary.

Mr. BURKE. Does that complete all the questions?

Thank you very much, Mr. Hobbs. We appreciate your appearance.

Mr. HOBBS. Thank you.

Mr. BURKE. Our next witness is the former Commissioner of the Social Security Administration, Hon. Robert M. Ball.

We welcome you back to the committee, Mr. Ball. You look well rested and tanned up.

STATEMENT OF ROBERT M. BALL (FORMER COMMISSIONER, SOCIAL SECURITY ADMINISTRATION), SENIOR SCHOLAR, INSTITUTE OF MEDICINE, NATIONAL ACADEMY OF SCIENCES, WASHINGTON, D.C.

Mr. BALL. Thank you, Mr. Chairman.

I just came from your general part of the country, New Hampshire. I was a little late. One of those little feeder lines canceled their first flight so that I got the next one.

Mr. Chairman, I am appearing here as a private individual. My current connection is as senior scholar at the Institute of Medicine, which is part of the National Academy of Sciences.

As you suggested, I was Commissioner of Social Security from 1962 until April of 1973, and prior to that, beginning about 1950, held quite high civil service level jobs in the Social Security Administration so that my acquaintance with the program is over a very long period of time.

Mr. BURKE. I would say you are well qualified.

Mr. BALL. Mr. Chairman, you have had witnesses who have testified to the facts of the present financial situation, and I feel that it would be highly redundant for me to take the time of the committee to repeat the factual situation.

With your permission, what I would like to do is read about the first two pages of this statement of mine, which is a summary of policy position that I would take on the fact, and maybe just hit one or two other key points, and then have the full statement in the record.

Mr. BURKE. You may summarize, and your entire statement will appear in the record, without objection.

Mr. BALL. Thank you, Mr. Chairman.

Since the first two pages give the essence of what I consider the right legislative plan, I thought that it might be most helpful to the committee if I actually did read that part of the statement.

As you all know, during the past year there have been many alarmist stories about social security financing. The 30 million people, 1 out of 7 Americans now receiving social security benefits, and the nearly 100 million workers contributing to the program are concerned. I hope that the Congress will meet this concern by passing legislation this year—although with a later effective date—that will form a proper basis for the restoration of full confidence in the financing of the social security system.

I might say, Mr. Chairman, that unlike the previous witness, I believe that the social security program has been a very unusually successful program overall and is perhaps, I would say, probably without question the most important social reform movement and reform institution that we have had in this last two generations, and I think our concern should be for the restoration of its financial health, not major modifications in the general approach of the program.

So I am addressing myself just to the question of how one can restore financial health to the system.

If the maximum amount of earnings credited for benefits and on which contributions are paid is increased to \$24,000 in 1977 it is possible by a rescheduling of the contribution rates provided for in present law to cover all outgo for the cash benefit system for the next 35 to 40 years without increasing the contribution rates above the level now set, and without relying on any other source of income.

To accomplish this objective, the scheduled 1978 contribution rate increase of 0.2 percent of payroll for employees, with a like amount for employers—this is in present law—should be allocated to the cash benefit program and not to the medicare program as now provided. With the higher benefit and contribution base of \$24,000 in 1977, it is not necessary to also have an increase in the medicare rate of 1978, but the increase is needed for the cash benefit program.

Under the assumptions in the latest reports of the Boards of Trustees, these changes would result in the cash benefit program having more income than outgo, year by year, until sometime between 1985 and 1990. I would hope that the legislation passed this year

would also move up the 1-percent contribution rate increase now scheduled for 2011 that is also in the present law, to the date between 1985 and 1990 calculated here as the point when the fund would otherwise decline.

This 1-percent rate would be allocated 0.2 percent to hospital insurance which, although it doesn't need the money at the time, by the 1980's would need it, and 0.8 percent to cash benefits. These combined actions would carry the cash benefit program to some time between 2010 and 2015, 35 to 40 years from now, under the assumptions used by the board of trustees. It would also keep the hospital insurance program in actuarial balance over the 25-year period for which estimates are made for that program.

I want to make clear, Mr. Chairman, that in saying that these changes in financing will carry the program for 35 to 40 years I am assuming that the Congress would never allow the present automatic provisions to develop in such a way that benefits for a high proportion of those coming on the rolls would exceed the highest wages they had ever earned.

Under the automatic provisions in present law this can theoretically happen in the next century under certain wage and price assumptions, although under other assumptions it would not. Such a benefit result is clearly contrary to the intent of the automatic provisions and would certainly never be allowed to occur. Yet this purely theoretical possibility accounts for about 45 percent of the long-range actuarial deficit shown in the last trustees' reports.

This is not a real deficit and should certainly not be funded. It would be a great mistake to provide financing for benefits at the time of retirement that for many, many people exceeded the highest wages they had ever earned. I am assuming, therefore, that the deficit we should be paying attention to in the trustees' report is the 2.9 percent of payroll that they show in the latter part of their report for a system which keeps benefit protection fully up to date with rising wages, and thus with the level of living of the community as a whole, but does not allow protection to increase automatically more than wages increase.

Any increases that go beyond keeping up the date with wages should not be the accidental result of the movement of wages and prices under the automatic provisions, but should be a deliberate congressional decision. To summarize this point: The 5.3 percent of payroll deficit that the trustees show in the first part of their report arises only because the wage and price assumptions they have chosen for the long-range cost estimates—and they are as good a guess as any others—produce benefit levels around the years 2040 to 2050 that have run ahead of the assumed increases in wages by over 50 percent. The benefit results of these assumptions, then, are ridiculous and would never be allowed to occur.

There is no need to take action this year to change the automatic provisions. Under any set of reasonable assumptions, the present provisions work quite well for many years into the future, and the changes in the benefit provisions require a considerable amount of technical consideration. In the next few years, however, changes should be made in the benefit provisions to provide that those retiring in the next century will get benefits that are the same relationship to past earnings as is the case for those retiring today. Such a change would provide greater certainty of protection for covered workers and

doing it soon will prevent the future reporting of these large theoretical deficits which have been so upsetting to beneficiary and contributor alike.

Such a change in the next few years seems generally agreed upon. The change has been supported by the recent advisory council, the board of trustees, a panel of outside consultants that recently reported to the Senate Finance Committee, a number of independent experts, including Mr. Myers a few minutes ago, the AFL-CIO, and by organizations of senior citizens. The President has also given general approval to such a change.

Thus it would seem safe to assume that either wages and prices will move in such a way as to make the benefit results of the present automatic provisions reasonable, or that some time in the next several years the provisions will be changed so that benefit protection for contributors rises directly with wages.

In either case, the realistic long-range deficit that should be addressed under the assumptions of the boards of trustees is 2.9 percent of payroll, not 5.3 percent. With the financing changes I suggested earlier as a solution for the short-run financing problem, the long-range deficit of 2.9 percent of payroll becomes less than 2.5 percent.

Mr. Chairman, the question of what should be done 35 or 40 years from now about a possible 2.5 percent of payroll deficit does not seem to me a matter that has to be decided at this point. Whether or not such a deficit does occur depends upon a series of highly speculative assumptions. I happen to think it is likely that there will be a deficit in this range and may own feeling is that if it turns out to be as we get near it I would support the idea of there being a gradual introduction of a general revenue contribution to at least help meet that size deficit, but I don't think that decision has to be made now.

It is perfectly possible to move within the present contribution rates, make a change in the wage base and satisfy the financing for the whole next generation.

There are only two other points that I would just like to pull out of this statement and mention orally, and then I would be happy to answer any questions that you or the committee may have.

One point, Mr. Chairman, is that I would like to stress a historical fact growing out of my experience over the years with social security and with this committee, and with the Senate committee. That is that, contrary to some reports I have seen, the present shortfall in social security financing is not the result of Government irresponsibility, it is just not true that the Congress was willing to vote for benefit increases but not willing to vote for the contribution rate increases to cover those costs. That is not at all what happened.

As has been true of every major piece of social security legislation in the past, at the time of the 1972 amendments, the 20-percent benefit increase and the automatic provision, it was thought by the Congress and by the Executive that those provisions were adequately financed.

The 1973 trustees report that was issued a few months after the 1972 amendments, showed the system on a long-range actuarial basis to be out of balance about 5 percent relative to the total cost of the system, about 0.5 of 1 percent of payroll which, given the uncertainties of 75-year estimates, was considered to be an approximate balance.

It is the shifts that have occurred in both the short-range financial situation because of the rapid inflation, the large rate of unemployment, and the change in the assumptions about long-range fertility rates

that now presents the program as having these major deficits, and not at all a failure on the part of Congress to be willing to pass whatever contribution rates were necessary on the best advice that was given them for the benefits that they were voting.

The only other point that I want to call especially to the attention of the committee, Mr. Chairman, is perhaps seen best in relation to the table that I attached to this statement where correctly, quite correctly, a great deal has been made of the expected growth in the proportion of people beyond 65 in the next century as compared to people of what has been thought to be normal working age, 20 to 45. And you will see, if you look at this table, that in the lower half of the table I have included the number of people 65 and over per 100 workers between 20 and 64.

That is, the table 65 and over as a number of people 65 and over per 100 people of working age. You will see that where in 1930 there were 9.7 people 65 and older related to those of working age by 1973 it was at 18.6. That doesn't change very much up until about 2010.

It just goes along to 19.5 and then it really takes off so that by 2040 you have 30 people 65 and over for those of working age.

As I say, a great deal has been correctly made of those consequences of the new assumptions about the lower rate of fertility. But what has not received very much attention, Mr. Chairman, is that at the same time that that is going on the same assumptions that produce this increase in the proportion of older people to those of working age necessarily produces a declining proportion of those below 30 compared to those of working age.

Although that does not automatically get the social security system out of its parochial problem of financing, you might say it is important to keep in mind if you are thinking of the fundamental economics of how many people does an active worker have to support, and I am merely suggesting that we keep in mind that we are not faced from this fertility change with this specter that I have seen in some articles of each worker carrying more dependents in the next century than he does today.

If you look at the combined dependency ratio over on the right-hand side, and that means putting together those under 20 and those over 65, compared to per hundred of working age, there is actually a decline from where we are today all through the first half of the next century, so that from that more fundamental question we are not faced with a terrible economic difficulty here of each active worker having to support a lot of extra dependents.

We have an internal technical allocation problem you might say, Will people because they have fewer children to raise be willing to pay higher contribution rates for retirement? It is more that than it is the other.

Mr. Chairman, that completes what I had in mind to say on my own initiative to the committee. I would be glad to answer any questions.

[The prepared statement follows:]

STATEMENT OF ROBERT M. BALL, SENIOR SCHOLAR, INSTITUTE OF MEDICINE, NATIONAL ACADEMY OF SCIENCES (COMMISSIONER OF SOCIAL SECURITY, 1962-73)

Mr. Chairman and members of the committee, as you all know, during this past year there have been many alarmist stories about social security financing. The 31 million people, 1 out of 7 Americans, now receiving social security benefits, and the nearly 100 million workers contributing to the program are concerned. I

hope that the Congress will meet this concern by passing legislation this year (although with a later effective date) that will form a proper basis for the restoration of full confidence in the financing of the social security system.

If the maximum amount of earnings credited for benefits and on which contributions are paid is increased to \$24,000 in 1977, it is possible by a rescheduling of the contribution rates provided for in present law to cover all outgo for the cash benefit system for the next 35 to 40 years without increasing the contribution rates above the level now set and without relying on any other source of income. To accomplish this objective, the scheduled 1978 contribution rate increase of 0.2% of payroll for employees, with a like amount for employers, should be allocated to the cash benefit program and not to the Medicare program as now provided. With the higher benefit and contribution base of \$24,000 in 1977, it is not necessary to also have an increase in the Medicare rate of 1978, but the increase is needed for the cash benefit program. Under the assumptions in the latest reports of the Boards of Trustees, these changes would result in the cash benefit program having more income than outgo, year by year, until sometime between 1985 and 1990. I would hope that the legislation passed this year would also move up the 1% contribution rate increase now scheduled for 2011 to the date between 1985 and 1990 calculated as the point when the fund would otherwise decline. This 1% rate would be allocated 0.2% to hospital insurance and 0.8% to cash benefits. These combined actions would carry the cash benefit program to sometime between 2010 and 2015, 35 to 40 years from now, under the assumptions used by the Boards of Trustees. It would also keep the hospital insurance program in actuarial balance over the 25-year period for which estimates are made for that program.

I want to make clear that in saying that these changes in financing will carry the program for 35 to 40 years I am assuming that the Congress would never allow the present automatic provisions to develop in such a way that benefits for a high proportion of those coming on the rolls would exceed the highest wages they had ever earned. Under the automatic provisions in present law this can *theoretically* happen in the next century under certain wage and price assumptions, although under other assumptions it would not. Such a benefit result is clearly contrary to the intent of the automatic provisions and would certainly never be allowed to occur. Yet this purely theoretical possibility accounts for about 45% of the long-range actuarial deficit shown in the last Trustees Reports!

This is not a real deficit and should certainly not be funded. It would be a great mistake to provide financing for benefits at the time of retirement that for many, many people exceeded the highest wages they had ever earned. I am assuming, therefore, that the deficit we should be paying attention to in the Trustees Report is the 2.9% of payroll that they show in the latter part of their Report for a system which keeps benefit protection fully up to date with rising wages, and thus with the level of living of the community as a whole, but does not allow protection to increase automatically more than wages increase. Any increases that go beyond keeping up to date with wages should not be the accidental result of the movement of wages and prices under the automatic provisions, but should be a deliberate congressional decision. To summarize this point: The 5.3% of payroll deficit that the Trustees show in the first part of their reports arises only because the wage and price assumptions they have chosen for the long-range cost estimates (and they are as good a guess as any others) produce benefit levels around the years 2040 to 2050 that have run ahead of the assumed increases in wages by over 50%. The benefit results of these assumptions, then, are ridiculous and would never be allowed to occur.

There is no need to take action this year to change the automatic provisions. Under any set of reasonable assumptions the present provisions work quite well for many years into the future, and the changes in the benefit provisions require a considerable amount of technical consideration. In the next few years, however, changes should be made in the benefit provisions to provide that those retiring in the next century will get benefits that are the same relationship to past earnings as is the case for those retiring today. Such a change would provide greater certainty of protection for covered workers and doing it soon will prevent the future reporting of these large theoretical deficits which have been so upsetting to beneficiary and contributor alike. Such a change in the next few years seems generally agreed upon. The change has been supported by the recent Advisory Council, the Boards of Trustees, a panel of outside consultants that recently reported to the Senate Finance Committee, a number of independent experts, the AFL-CIO, and by organizations of senior citizens. The President has also given general approval to such a change.

Thus it would seem safe to assume that either wages and prices will move in such a way as to make the benefit results of the present automatic provisions reasonable, or that sometime in the next several years the provisions will be changed so that benefit protection for contributors rises directly with wages. In either case, the realistic, long-range deficit that should be addressed under the assumptions of the Boards of Trustees is 2.9% of payroll, not 5.3%. With the financing changes I suggested earlier as a solution for the short-run financing problem, the long-range deficit of 2.9% of payroll becomes less than 2.5%.

Mr. Chairman, the rest of my statement goes into the matters I have presented in more detail. I would propose that the remainder of the statement merely be inserted in the record.

Mr. Chairman, before turning to a discussion of the factors that have led to a current shortfall in social security financing, I would like to stress one additional point: Contrary to some reports I have seen, the present shortfall in social security financing is not the result of government irresponsibility. The Congress has not been voting increases in benefits and then been unwilling to vote the increased contributions necessary to pay for the benefits. This is just not so. Over the whole long history of social security, when benefits have been improved, full financing, based on the best information available has been provided at the same time.

As had been the situation in the past, when the social security amendments providing for automatic cost-of-living increases and a 20% benefit increase were signed into law in 1972, the system was thought to be adequately financed. The 1973 reports of the Boards of Trustees issued shortly after these amendments showed a long-range imbalance of $\frac{1}{2}$ of 1% of covered social security payroll, or an imbalance of about 5% relative to the cost of the whole program over the 70-year period for which social security estimates are made. This relatively minor degree of imbalance was considered acceptable considering the major uncertainties attached to such long-range estimates.

As previously indicated, the Trustees Report, issued May 2, 1975, showed the program to be out of balance for the long run by about 5.3% of payroll, or by almost $\frac{1}{2}$ relative to total costs, and to need at least some additional financing in the very near future. What has happened?

THE SHORT-RUN PROBLEM

For the short-run, the main problem is the unprecedented economic situation—high rates of inflation combined with a general slowdown in economic activity. The high rate of inflation is resulting in substantial increases in benefit outgo under the automatic cost-of-living provisions at the same time that the income of the system is substantially below expected levels because of the high rate of unemployment. As a result, according to the Trustees, social security outgo will exceed contribution income by over \$3 billion in 1975, and by nearly \$6 billion in 1976, and again in 1977.

The fact that social security benefit payments will exceed contribution income for a short time would not, in itself, be a proper cause for concern. This is why social security has the reserves it has. They should be drawn on in a period of recession like the present. For social security beneficiaries to get more money to spend than is being deducted from workers' earnings and paid by employers as social security contributions is, today, good for the economy. The annual deficit cannot, however, be allowed to continue. This short-run problem in social security financing is not a matter of speculation. Under any reasonable set of assumptions, social security income over the next 20 to 25 years falls short of what is needed by about 10%.

One way to solve the short-run problem—a way which would also help the long-run situation—is to increase the maximum amount counted for the computation of benefits and for contributions. Contribution rates are already quite high (5.85% of earnings) and to increase these rates which apply to all covered workers above the level already scheduled would certainly meet considerable resistance unless accompanied by major additional benefit protection. Increasing the maximum benefit and contribution base, on the other hand, would make the financing of the system more progressive and at the same time would increase protection for those who pay more.

Under the automatic provisions of present law, the maximum base rises as average earnings covered by social security increase. Thus under present law, the present maximum amount covered is \$14,100 this year and is estimated to be \$16,500

in 1977. I would propose that the maximum base be raised legislatively to \$24,000 in 1977, or perhaps it could be increased more gradually starting with a lower figure in 1977 but rising somewhat more later on.

In any event, the increase above what would result from the automatic provisions of present law should not start until 1977 for reasons of economic policy. Starting the increase in 1977 would mean that the change would have no effect until the fall of 1977—a time when we should be well on our way to economic recovery. It has little effect until fall because it is not until then that any significant number of workers would have earnings exceeding the \$16,500 base that would, in any event, be in effect for 1977 under the automatic provisions.

With this higher benefit and contribution base, the contribution schedule in present law would substantially over-finance the Medicare hospital insurance program for many years into the future. It would be possible, then, without weakening a sound financing plan for Medicare to shift to the cash benefit program the small increase in the Medicare contribution rate which is now scheduled to occur in 1978. This scheduled increase is 0.2% of payroll for employees and a like amount for employers.

These changes in financing will have two effects: (1) The cash benefit trust funds will start to build up again and under the most likely assumptions the build-up will continue past 1985 or even much later. Specifically, under this proposal, instead of an estimated decline in the trust funds of \$5.8 billion in 1977, \$6 billion in 1978, \$6.8 billion in 1979, and \$7.7 billion in 1980, the trust funds would decline by only \$600 million in 1977 and then increase by \$5.2 billion in 1978, \$6.6 billion in 1979, and \$7.5 billion in 1980. After these changes there would be no short-term financial problem for either the social security cash benefit program or the Medicare hospital insurance program. (2) The increase in the contribution and benefit base will increase the protection as well as the payments for the 15% of wage earners who are not now paying social security contributions on their full earnings. For example, a person earning at the maximum amount covered by social security and age 55 in 1977 would get, when he or she retired at 65, a benefit of over \$100 a month above what he or she would get under present law. An individual earning the maximum amount and age 60 in 1977 would get about \$50 a month more than under present law when he or she retires at 65.

The short-run problem in social security financing is easily manageable in this way, while retaining the self-financing principles that have been traditional in the American social security system. This approach avoids the need for higher contribution rates. It is also greatly to be preferred, in my opinion, to the proposal made by the majority of the Advisory Council to finance all of the Medicare hospital insurance program out of general revenues (five of the 13-member Council dissented from this recommendation). Making Medicare entirely dependent on general revenues could easily lead to a loss of the concept of a right to benefits and to the introduction of a means test into the program. Instead of a social insurance program, Medicare might in this way be turned into a relief program.

THE PROBLEM IN THE NEXT CENTURY

There may also be a longer-run problem in social security financing. But the 5.3% of payroll actuarial imbalance mentioned by the Trustees is made up of two quite distinct parts; they need to be considered separately. First of all, about 45% of this imbalance, 2.4% of payroll, arises solely because the wage and price assumptions used in the estimates would result in the next century in benefit protection rising over 50% more than the assumed increases in wages. A high proportion of people, under these assumptions, would get benefits when they retired higher than any wages they had ever earned. In other words, the benefit results of the set of assumptions used by the Trustees would be ridiculous and would never be allowed to go into effect. The law, of course, would be changed long before such a situation was reached because the results are clearly contrary to program purpose. Therefore, the estimate of an actuarial imbalance that should be realistically considered is 2.9% of payroll, not 5.3%.

But let's go into the nature of the automatic provisions somewhat more at this point to discover what it is about the provision that makes it even theoretically possible for social security benefit protection increases to run way ahead of increases in the general level of living.

The problem with the present automatic provision is that protection may rise under certain circumstances less than wages rise or under other circumstances more than wages rise, depending on the movement of wages and prices. The

desirable goal would be to have an automatic system which paid benefits in the long-range future which were the same proportion of earnings just before retirement as are paid to people retiring today. In the event that the country wished to provide protection that was a greater proportion of future wages than is supplied today, this should be done by new legislation.

The present automatic provisions are particularly vulnerable to a high average rate of inflation over the long run. With relatively low average price increases from year to year, say 2%, the present system works quite well, but if one assumes high average rates of inflation for the next 75 years—say 4% or 5%—it does not.

This is how the automatic provisions in present law work: Once people start receiving benefits, the amount payable is kept up to date automatically with increases in the consumer price index. Except for the fact that the adjustment needs to be more frequent and should be made in relation to a special price index for the elderly and poor—this part of the provision works well. For people on the benefit rolls, the automatic provisions provide for the protection of the purchasing power of the benefit. It is assumed that from time to time Congress may wish to raise benefits further to adjust them to improvements in the level of living of the community generally, but the automatic provisions merely protect the purchasing power of beneficiaries. I would not propose to change this in any fundamental way and neither would the recent Advisory Council on Social Security.

For those who have not yet retired—those still contributing to the program—the automatic provisions do much better than keep the protection up to date with prices. The benefits payable to a retired worker are determined by a table in the social security law. For each average monthly wage interval, as defined for social security purposes, there is a specified retirement benefit amount. Now, under the automatic provisions, when the consumer's price index goes up, the benefit amount for each average wage interval is increased by the same percentage as the rise in the CPI. Thus a \$300 average monthly wage in May produced a benefit of \$214.40. In June there was an 8% benefit increase and the table in the law has been rewritten so that in the future an average monthly wage of \$300 will produce an 8% higher benefit, or \$231.70. This change provides full compensation for the price increase.

As prices rise, however, so do earnings, and the higher wages are included in the computation of the average monthly wage on which the social security benefit is based. Thus, when it comes time for the worker who had been earning a \$300 wage to retire, his average will no longer be \$300 but—depending on the number of wage increases that have accumulated over his working lifetime—may be \$400, \$500, or \$600. So when it comes time to compute his benefit, it is no longer the benefit shown in the table for the \$300 average wage that counts, but the benefit amount related to some much higher average wage. It is a combination, then, of the increase in the social security benefit for a particular average wage-level—an increase which alone fully reflects the higher cost of living—plus the increase in the average itself which results in an updating of the level of protection for those still contributing to the program. This, of course, is considerably more than enough to keep up with prices.

The question becomes: How much more than prices? If the protection is kept up to date enough more than prices so as to keep up with wages, the result would seem to be highly satisfactory. This would mean that social security protection was keeping up to date with increases in the general level of living of the community and that the ratio of social security benefits to earnings just before retirement remained stable. This is approximately what does happen if one assumes an average productivity increase of 2% a year and a relatively low inflation rate, say 2%. On the other hand, as I indicated, if you assume, as the Trustees did, an inflation rate of 4% and a productivity increase of 2%, so that while prices rise at 4% a year, wages are rising at 6%, the combined cumulative effect is that benefit protection in the next century increases much more than wages. If one assumes an average rate of inflation of 5% with wages rising at 7%, the cumulative effect on the relationship of benefits to wages earned is even more ridiculous with still larger numbers of people receiving benefits greatly in excess of their highest wages.

On the other hand, there is no actuarial deficit at all if the rate of inflation is kept to 2% on the average and wage increases average 5% because under these assumptions benefit protection does not even keep pace with wage increases.

The way to cure the appearance of a financing problem that arises from the sensitivity of the formula to assumptions about the rate of inflation is to change the

formula so that benefit protection rises directly with increases in wages. This is a good idea anyway because it stabilizes the relationship of benefits to wages and gives contributors the security of knowing what percent of their wages at retirement will be paid in benefits. At the same time the current estimate of a long-range actuarial imbalance of 5.3% of payroll is reduced to 2.9% by this one change.

The Advisory Council proposal to base benefits on a system of wage indexing—a system similar to the one used for some time in West Germany—seems to me a good way to accomplish the objective. It provides that benefits in the long-range future will be the same proportion of earnings just before retirement as are benefits being paid today to people retiring today. This would give contributors the security that they need and would remove from the discussion of long-range social security financing the highly unreal “cost” attributable to assumptions that show benefit protection outpacing wage increases.

THE LONG-RANGE EFFECT OF THE PROPOSALS MADE TO SOLVE THE SHORT-RUN PROBLEM

The estimate of 2.9% of payroll actuarial deficit projected over the next 75 years would be reduced to under 2.5% as a result of raising the maximum benefit and contribution base to \$24,000 in 1977 and by applying the scheduled 1978 increase in the contribution rate to the cash benefit program, as recommended earlier. Thus, under the latest estimates of the Trustees we have left a possible actuarial deficit of under 2.5% of payroll, all of which occurs in the next century. What causes this possible deficit?

THE PROBLEM OF THE NEXT CENTURY

The 1975 reports of the Boards of Trustees indicate that under certain population assumptions there will need to be significant additional social security financing because of very dramatic changes in the age composition of the population. These changes arise from the assumption that the low fertility rates of recent years will continue. Since 1957, the expected number of births per woman has steadily declined from the rate of 3.77 estimated for that year. By 1965, the rate was 2.93; by 1970, 2.48; and by 1974 it was 1.9.

The Trustees have assumed that the decline will continue until the rate reaches 1.7 in fiscal year 1977 and that the rate will then slowly climb to an ultimate level of 2.1 children per woman in 2005, a rate which is about the rate producing zero population growth in the long run. The results of the change to this assumption from the assumption of 2.5 children per woman used in the 1973 report (the report which found the system to be in balance) are startling. Instead of the United States population moving up from 220 million in 1974 to 312 million in the year 2000, and to 515 million by 2050, under the 1975 assumptions there will be 264 million in the year 2000 and 308 million in 2050, with near zero population growth being reached at that time.

But it is the shift in the age composition of the population that is so significant for social security financing. In 1940 there were 77 million persons in the group of working age—20 to 64—and 9 million people over 65, a ratio of 11.7 aged persons for every 100 persons of working age. Comparable figures in 1974 are 120 million and 22 million, for a ratio of 18.3 aged for every 100 persons of working age. Under the assumption in the 1975 Trustees' report, there are only minor fluctuations in this ratio between now and 2010, but at that time the growth in the age 20–64 population comes to a halt, while the number of people aged 65 and over shoots up from 33 million in 2010 to 51 million in 2030, resulting in a ratio of 31 people past 65 for every 100 persons of working age. (See table attached.)

Thus the result of assuming the continuation of the low fertility rates of the recent past is a population distribution beginning about 2010 that will require the active labor force to support a much larger retired population relative to the size of the labor force than is now true. This is so, of course, quite aside from social security. With these population changes, if all the support for the retired aged were to come from private pensions, or a negative income tax, or from private savings, or relief, or the support of working-age children, the fundamental economic fact would still be that it would take a higher proportion of the goods and services produced by active workers in the next century to support older people than it will in this century, assuming a continuation of the same relative living standards between the two age groups.

Fortunately, the increasing demand on goods and services by the aged resulting from these new population projections will be offset by a decline in the number of younger dependents. If we look not just at the elderly but at the combined number of people below 20 and over 65 and consider this combined group to be the number to be supported by active workers, we get a very different picture than when looking at the aged alone. Even allowing a higher per person living cost for older people than for children, it still can be said with considerable confidence that the kind of population shift that would occur under the 1975 Trustees' assumptions does not represent an increase in the overall economic burden on active workers, but rather an increased obligation to support older people, balanced by a lessening of the obligation to support children. (See table attached.)

From the narrow point of view of the closed system of social security, however, there may well be a problem. Since about four-fifths of the cost of the system is for the payment of benefits to older people, the lower cost to the system for benefits to children is offsetting to only a minor degree. Looked at strictly from the standpoint of the social security system in the next century, the issue could well become how the "savings" to active workers from the lessened burden of raising children can be translated into a willingness to pay higher contribution rates for retirement protection.

EVALUATING THE LONG-RANGE ESTIMATES

But how certain is this short-fall in social security financing? Will there really be a problem of financing social security in the next century?

Perhaps the first point to be dealt with in answering this question is to ask whether it is reasonable to expect fertility rates to remain below the rate needed for zero population growth until 2005 and then stabilize at the zero population growth rate of 2.1. If we look not at the period just since 1957 but, say, over the last 75 years, there have been many ups and downs in the fertility rate in the United States. It was high at the turn of the century, dropped sharply during the depression of the 1930s, began to rise during World War II, and remained on the rise until 1957. If the fertility rate were to rise quickly to the 2.5 level—about where it was from 1967 through 1970—there would, of course, be no social security financing problem of the type now anticipated.

Population experts have, on the record, not been particularly successful at predicting fertility rates, and in that sense everyone can take his choice on the basis of experience. Yet, it would seem imprudent to count on there being a major reversal of the long-extended decline in the fertility rate since 1957 and in this way dismiss any long-range social security financing problem. The widespread knowledge about, and availability of, inexpensive (for the United States) methods of contraception, the tendency to prefer a higher level of living made possible by a smaller family, and the widely recognized major social reasons for zero population growth persuade me that it is reasonable to base projections of social security costs on a fertility rate ultimately producing zero population growth. I believe we should assume that there will be a larger number of those who will take out of the social security funds in the next century relative to those who will pay in, as compared with what has previously been assumed to be the case.

But we have been ignoring another fundamental factor. If productivity were to increase enough, and if some of the increase were used disproportionately to support the aged, the cost effects of the population shift could be offset rather painlessly. It may well be that our recent experience of very low or even zero increases in productivity have made us unduly pessimistic about the level of productivity increases for the long run. Perhaps over the next 75 years we will achieve an average increase of $2\frac{1}{2}\%$ or 3% a year instead of the 2% assumed in the various recent cost estimates. When we can begin to place major reliance on new power sources (hopefully in the next century not only on the conventional water-cooled nuclear fission reactor of today, but on the much more efficient liquid metal reactor, the power breeder, and perhaps on safer and what might prove to be even more efficient thermonuclear fusion, plus solar and geophysical power sources) perhaps productivity increases will be at significantly higher rates than for the last 20 years when we experienced slightly less than 2% average increases. For the period from 2000 to 2050, say, there need be no lack of industrial power, and the application of the scientific method to production and the efficient use and reuse of raw materials has a long way to go.

Thus it could be that the anticipated problem for social security financing caused by the expected population shift may not occur, either because the fertility rate rises quickly to the 1970 level or because productivity increases are greater than has been assumed. As indicated, however, it seems prudent to assume that the demographic shifts will occur. And, at the same time, it would not seem prudent to count on optimistic productivity projections to fully offset these demographic shifts. On the contrary, the prudent course would seem to be to consider a 2.5% of payroll long-range actuarial deficit, while by no means certain, to be a real possibility even after we have modified the benefit formula and done the things that should be done about short-run financing. After all, although unlikely, it is possible that fertility rates would stay below those needed for zero population growth and that the increase in productivity might be even less than the 2% increases now being assumed.

One thing that can be done to reduce the possibility of such a deficit in the next century has to do with the declining rate of labor force participation by older people.

The most significant social trend causing higher than necessary social security costs in the next century is this trend toward earlier retirement. In the Trustees' reports the actuaries assume a continuation of this trend—an assumption that results in additional costs to the system. If we could reverse this trend and have greater labor force participation among older people in the next century than we have today, there could be a significant saving for social security over the costs currently estimated.

There may well be a question whether a policy of earlier and earlier retirement makes sense—either for the individual or for society—when one considers the probability of more older people living somewhat longer and with a high proportion of those in the younger part of the aged population being in reasonably good health. One quite possible and highly rational response to the change in the age distribution of the population now being predicted would be for society to employ a higher proportion of older people rather than a lower proportion as has been assumed in the cost estimates.

The most fundamental determinant of the cost of pensions is the proportion of the aged group that is productively employed. This is true because private plans almost always require retirement from the particular employer or industry as a condition of drawing benefits, and social security reduces benefits in proportion to earnings for those who earn more than relatively low exempt amounts. (It is to be noted that if social security financing is to gain substantially by any increase in labor force participation by older people, the system must remain a retirement system and not pay benefits to older people whether they continue to work full time or not.)

In summary, I believe we should plan for the continuation of a low fertility rate. The result may not be as serious as the latest Trustee's report shows, but I do believe that after 2010 there will be a larger number of people taking out of social security as compared to those paying in than has previously been assumed. To counter this situation I would urge that we support measures to increase labor force participation rates among older people. I believe, also, that as the Advisory Council has recommended, we should modify the automatic provisions of present law so that contributions have the certainty of benefits rising with future wages. This change has the additional result of showing a substantial reduction in the cost of the program as compared with the most recent estimates. I would also raise the maximum earnings base to \$24,000 in 1977, allocate the 0.2% of payroll increase in the contribution rate scheduled for 1978 to the cash benefit program rather than to Medicare, and move up the rate increase now scheduled for 2011. These changes, under the Trustees' assumptions, adequately finance the cash benefit program for at least 35 to 40 years in the future.

If in the next century it turns out that these changes are insufficient to fully support the program on a self-financed basis, I would favor the gradual introduction of a government contribution. But there is no hurry about this decision. The need for such a government contribution rests on highly speculative assumptions about what will occur many, many years into the future—assumptions about fertility rates, mortality rates, labor force participation rates by older people and the productivity increases we may expect.

In any event, the one out of seven Americans now drawing social security benefits, and the 100 million people contributing to the program each year have every right to feel secure that their government will keep its part of the social security compact. The financing problems of social security, both in the short and in the long run are of clearly manageable proportions.

ACTUAL PAST AND PROJECTED FUTURE POPULATION OF THE UNITED STATES BY BROAD AGE GROUPS, AND
DEPENDENCY RATIO

Year	Population (in thousands)				Dependency ratio ¹		
	Under 20	20 to 64	65 and over	Total	Under 20	65 and over	Total
1930 ²	47,609	68,438	6,634	122,681	69.6	9.7	79.3
1940 ²	45,306	77,344	9,019	131,669	58.5	11.7	70.2
1950 ²	51,295	86,664	12,257	150,216	59.2	14.1	73.3
1960 ²	73,116	98,687	17,146	188,949	74.1	17.4	91.5
1970 ²	80,637	112,500	20,655	213,792	71.7	18.4	90.0
1973 ²	79,665	117,956	21,916	219,538	67.5	18.6	86.1
1990 ³	71,929	147,457	28,789	248,176	48.8	19.5	68.3
2000 ³	76,333	157,038	30,214	263,585	48.6	19.2	67.8
2010 ³	76,222	167,432	32,662	276,316	45.5	19.5	65.0
2020 ³	78,561	167,873	42,061	288,494	46.8	25.1	71.9
2030 ³	80,768	164,636	51,227	296,632	49.1	31.1	80.2
2040 ³	81,989	169,501	50,806	302,296	48.4	30.0	78.4
2050 ³	84,462	173,843	49,352	307,657	43.6	28.4	77.0

¹ Dependency ratio is here defined as the total number of persons aged under 20 and/or over 65 per hundred persons aged 20 to 64.

² Figures for 1930, 1940, and 1950 are for the United States according to census counts. Figures for 1960 and 1970 are according to census counts and include adjustment for other areas covered by social security as well as for net undercount. Figures for 1973 are census estimates for the United States including net undercount, plus an adjustment for other areas covered by social security.

³ Based on the population projections prepared by the Office of the Actuary for the 1975 long-range cost estimates. Source: Office of the Actuary, Social Security Administration.

Mr. BURKE. Mr. Cotter.

Mr. COTTER. Thank you, Mr. Chairman.

Mr. Ball, you mentioned increasing the wage base to \$24,000 in 1977.

Mr. BALL. Yes.

Mr. COTTER. For us to act now to have it effective in 1977, then is that correct?

Mr. BALL. Yes.

Mr. COTTER. Have you given any thought to what the economic impact of that increase would be on the economy?

Mr. BALL. Yes, I have. The reason that I would recommend that you act now but with an effective date for 1977, is that a wage base increase has almost no economic impact until the fall of the year in which you put it into effect. That is clear, I am sure, because at that time the wage base under the automatic provisions would be roughly \$16,500. Very few people would have gone over \$16,500 until the fall of the year.

At that time, if you had the \$24,000 base you would start to collect more money from people who earn more than \$16,500, but not until then, and it has seemed to me that recovery should be at a phase hopefully much before the fall of 1977, but certainly by the fall of 1977, where the economic impact of a reduction of purchasing power on the part of the 15 percent of workers who would be affected by this change would certainly not be unacceptable from the standpoint of economic policy, and just speculatively I can imagine that we might even be glad to have a slight lack of expansionism by the fall of 1977.

Mr. COTTER. But that difference between \$16,500 and \$24,000, 5 percent, appears to me to be a lot of money that you are taking out of the economy.

Mr. BALL. It is an increase of about 7 percent.

As I say, would not suggest doing it earlier. However you do it, contribution rate increase or the wage base, whatever you do, when-

ever you do it the impact of it is to reduce the purchasing power of workers, and I would not want to see either one done until 1977.

The wage base increase comes a little later. It comes in the fall of 1977.

Mr. COTTER. You also mentioned about putting general revenue money in at some point if necessary. When would that be, or when do you envision it? If the \$24,000 is not sufficient, is that what you had in mind?

Mr. BALL. Yes; I would like to solve the financing problems of social security for the next 35 to 40 years without general revenue.

Mr. COTTER. You feel the \$24,000 base would do it?

Mr. BALL. Would do it with the rescheduling of contribution rates already in the present law. You would have to do both. That would carry you to probably around 2015. As we approach that time there is a great deal of additional knowledge that we will have the closer we get to it, whether this is really going to develop. It depends on such things as whether the fertility rate assumptions that the actuaries have adopted turn out to be the right ones. All you have to do is come back to the fertility rate very quickly to about where it was in the late 1960's and this problem disappears. Even if the actuaries are right on this selection of fertility rates, if we were fortunate enough to have somewhat higher productivity increases than have been assumed, a large part of the problem could be handled by a reallocation of part of that productivity.

So that I am not quarreling with the general size of this 2.5 percent of payroll long-range deficit that would remain after what I am proposing was adopted but I am saying we don't really know. It is a long way off. If it turns out to be correct I think a gradual introduction of general revenue would be a satisfactory answer, but I say we don't have to face it now.

Mr. COTTER. Thank you very much.

Mr. BURKE. Mr. Archer.

Mr. ARCHER. Mr. Ball, you do not mention what your recommendations would do to the disability fund.

Mr. BALL. I should have been more specific on that, sir. I was treating both the cash, that is old age and survivors and disability as a single cash program and these deficits that I am speaking to are for the combined program.

But you make a very good point. A significant part of the increase in the deficit shown by the 1975 trustees report is because of changed expectations about the amount of disability that they are now projecting as a result of recent experience in the disability program.

Mr. ARCHER. From your background and experience in the program, can you give this committee any insight as to why you think the increase has been so dramatic in the disability benefits, far beyond any projections that the actuaries had made?

Mr. BALL. I really have not been able to pin that down and I don't believe the Social Security Administration has, and your own staff of your committee working together with the Library of Congress issued a comprehensive report on this matter.

It has not been possible to determine whether, for example, there has actually been a liberalization of administrative decision. That possibly is one part that over time with court decisions and precedent decisions there is some liberalization. Personally, I think there might

be some but I don't think it has been a major thing. Speculation, again, but I think this one I would be quite sure has some merit to it, is that as the program has become better known, you get people filing for claims who probably in the early days didn't file.

Now, the rate of disability allowance of those who have filed an application has not varied a great deal over the years but you may be getting a higher proportion of those who potentially could get benefits, and that could explain somewhat the increased disability favorable decisions as the proportion of the total exposed population.

I am inclined also to think that there should be some changes in the administrative arrangements in disability that would assure us that we were getting more uniform decisions both in the initial determination and in the appeals process.

You will remember that this is a contracted out decision in the first instance with the State and so you have 50 different jurisdictions although operating under Federal regulation, nevertheless, with more independence than if they were directly a part of the Federal decision-making establishment.

Then you have a highly independent appeals group really with all the protection of independent judges looking at individual cases with a tendency toward overturning the cases that come up to them. I think both of those things led to kind of an increase in the cases.

Mr. ARCHER. I was surprised at your comment that the Congress was not responsible for the deficit in funds. If my recollection is correct, the actuaries under the standard level of earnings concept said that they had an accuracy of 0.1 percent of payroll plus or minus, and that they had that tolerance that they could work within, but that when we went on the dynamic earnings concept in 1972 the actuaries said that they would have to have a tolerance of plus or minus 0.5 percent of payroll.

In other words, they could not be as accurate in their projections and it has turned out that they have been 10 times more inaccurate than what they told us at that time.

Now we are at a minus 5.32 percent, which you have talked about and broken down. In 1972, the Ways and Means Committee never deliberated this increase. There was never any detailed consideration given to it. It was adopted in the conference committee and I understood that there were reservations that were presented at the time as to what we were doing with the 20-percent increase in benefits, and no increase in taxes. But I do know that in 1973 as a member of the Ways and Means Committee that I participated in a very cursory consideration of what was done in 1973, and we were specifically told by the actuaries that since we had gone to this dynamic level of earnings concept that they were not going to be as accurate. Whereas, before under the standard level earnings concept the Congress had never approved a program that was below minus 0.1 percent of payroll because that is the tolerance that the actuaries said they could live with, but because they became less accurate the majority in Congress decided it would build a deficit of 0.5 percent of payroll into the program because of the greater tolerance of inaccuracy.

That to me makes no sense whatsoever. I suppose by that same concept you would say it would be responsible for the Congress to say that since the tolerance now is plus or minus 5.32 percent that we can plan a 5.32-percent deficit in the program.

I think that was irresponsible on the part of the majority in Congress in 1973 and I am sorry to hear you say that that was a responsible action.

Mr. BALL. There are several points to respond to.

Mr. BURKE. I think, Bill, that you are making statements here that won't bear up under the facts.

Mr. ARCHER. The facts are there, Mr. Chairman.

Mr. BURKE. It is nice to have hindsight. It is nice to Monday morning quarterback about the information we had in 1972 about the 20-percent increase, and I just relate to that because I don't take credit for the other amendment which was pushed by the administration.

Mr. ARCHER. Mr. Chairman, it is not hindsight because I so stated at the time, and that was not the administration, that was a compromise presented by Mr. Corman in the committee in 1973.

Mr. BURKE. It was backed by the administration.

Mr. ARCHER. No; it was not backed by the administration.

Mr. BURKE. Anyway, on the 20-percent increase we were informed that there would be a surplus in the fund. That was the information we had at that time. Anything that happened after that I think that the administration and some Members of the Congress can take the blame for. I don't think you can blame it on Congress alone because all the time I was on the committee any time we increased the benefits we always provided the revenue and we had the courage to provide the revenue because we knew it was needed.

That is the problem today. We know that there is some revenue needed. We know it has to be done but as the saying goes, nobody wants to bite the bullet now. Everybody says 1977. We know now that there is a deficit.

Mr. STEIGER. That is not what Mr. Ball said. He said do it in 1977.

Mr. BURKE. That is all right for Mr. Ball to say that. We are the elected officials. We are answerable to the people.

Go ahead, Mr. Archer. I am sorry to interrupt.

Mr. ARCHER. You interrupted Mr. Ball, I believe.

Mr. BALL. Mr. Archer, I have two or three points. One is that perhaps we should separate out the two parts of the 1972 amendments. The administration supported the automatic cost of living provisions and they were adopted in the form that the administration recommended.

These were traditional cost of living proposals that had been around for a long time and introduced in much the same form by Mr. Byrnes. They were always thought to be self-financing in the sense that the increase in earnings, not just the base, but in earnings generally in running ahead of the cost of living would be sufficient to cover the cost of the automatic provisions.

That was the administration position that the cost of living provisions were adequately financed by the proposal they had. The 20 percent increase was thought to be adequately financed really when you shifted over to a dynamic basis of making the cost estimates.

I would quarrel with you about the actuaries saying that their level wage approach was more accurate. I would just change that to say it was more conservative. So that was a leeway.

Mr. ARCHER. Mr. Ball, I can tell you that the record is very clear that the actuaries said that their tolerance for accuracy was much

better under the standard level earnings than it was under the dynamic level earnings.

Mr. BALL. If you change the word slightly I don't think you and I have a real quarrel.

Mr. ARCHER. I fear you might be trying to spin a web around me here now and I am not going to let you do it because the facts are clear as to what the actuaries said. You have more knowledge about social security than I do because of the many years you have been in it but I sat in the committee and listened carefully and I know what they said and what the committee did in 1973.

Mr. BALL. Let's skip the web and go to the conclusion and see if we really have a difference. It was the traditional position on the part of social security actuaries that you should not have the system out of balance by more than 0.1 of 1 percent of payroll. That is clear. That was when they were making the estimates on a level wage basis.

I was quarreling only with saying that that was a more accurate way to make the estimates. I do not quarrel with you in saying that you could only have a 0.1 when you are doing it in a conservative way, and you ought to have at least no more than 0.1, though I would say it was more accurate but didn't have the kind of cushion that the level wage assumption had.

I am not really quarreling with that conclusion but some of the points you are making.

Mr. ARCHER. I am pleased that you agree with me then that the majority in Congress did knowingly plan a deficit of 0.5 percent in 1973.

Mr. BALL. What I am saying is that the Congress took action on the 20 percent and on the cost of living combined with the best advice of the official social security actuaries at that time that this was an adequately financed plan. The trustees made the report in 1973. It is out 5 percent over a 75-year period of being out. That is what they found in 1973, 5 percent, and I think if you and I check the trustees you will find that they found that no cause for concern. That 5 percent of payroll is different than what had previously been the actuaries' own judgment, I agree with you.

Mr. ARCHER. Let me talk to you just quickly about this base increase because your testimony is contrary to some that we have had from other experts on social security.

You have said that to increase the base will not have any long-term effects on the program, as I understand you. Other witnesses have testified that whereas the base increase would give us additional money now, that in the long term it would compound our problems because it would increase the benefits and, therefore, we would have to make that up down the line.

I wonder if you would explain the divergence of your testimony from that of others.

Mr. BALL. I don't know what experts defended that way, Mr. Archer, but the position of the only experts on this subject that I know of has been traditionally that an increase in the wage base improves the long-range financial situation of the program, as well as the short range. The specific proposal that I made of \$24,000 in 1977 would lower the deficit for the 75-year period by about 0.4 of a percent of payroll. It is quite true that the savings are larger in the first part of that 75-year period than they are later but if

you average it over the 75-year period you have about 0.4 of a percent of payroll saving that you have made up by that time.

Mr. ARCHER. Thank you very much.

Mr. BURKE. Mr. Karth.

Mr. KARTH. Mr. Chairman.

Mr. Commissioner, if I understand what you are proposing it is that we now go to a \$24,000 base but that that base be effective in 1977 and not before, and that from there on the base increase in proportion to the increase in income.

Mr. BALL. Yes.

Mr. KARTH. So that if in 1990, just taking that as a date, the income has increased by 50 percent, then the base would be 36,000 instead of \$24,000. Is that correct?

Mr. BALL. That is correct.

Mr. PICKLE. Doesn't he also recommend a rate increase?

Mr. BALL. I recommend that the rate increase scheduled in present law, which is an increase of 0.2 of the employees' 1978 be put into the cash flow and that the 2011 rate that is in present law be moved up.

Mr. KARTH. To 1985.

Mr. BALL. The solution is a combination of an increase in the wage base and an increase in the contribution rate for the cash program. But I think it important to emphasize that I am not proposing increases in the contribution rate beyond those scheduled.

Mr. KARTH. And that we increase the benefit rate for those who would get more in retirement than they got during their highest years of work.

Mr. BALL. Yes.

Mr. KARTH. The only persuasive argument that I have heard for not increasing the base from \$14,000 to \$24,000 is that it would have a rather serious adverse effect on capital expansion and influence the creation of more jobs because of a lack of capital investment. How do you answer that, Mr. Commissioner?

Mr. BALL. Well, I think on the question of what role you want social security to play in the formation of capital, I was impressed though not persuaded by Mr. Feldstein's testimony, who has focused on this question of social security and capital formation I guess more than any other economist, and his quarrel is not with just the \$24,000 but he would like to finance social security under a much bigger funded arrangement as a way of increasing savings and, therefore, capital formation.

I am personally inclined to think that, if the experts come to the conclusion that we need more stimulus for capital formation in the country, that there are better ways of doing it than building up social security trust funds on the one hand, or refraining from proper contribution rates applied to a proper base to fund the program adequately.

If you say let's not increase the wage base your choice is going to have to be then to increase the contribution rate to take it all out of general revenue, and to increase the contribution rate beyond what seems to me a fairly stiff rate now for relatively low wage earners turns me in the direction of the higher wage base.

I am not able to say that that has absolutely no effect on capital formation. I think it might.

Mr. KARTH. And if we ought to assist capital formation we ought to do it through other means, including the general revenue code.

Mr. BALL. You must not forget, Mr. Karth, the fact that when the Germans changed from a funded system over to a pay-as-you-go type system they at the same time took other broad steps unrelated to social security that promoted capital formation. They changed tax laws in other ways to help that.

Mr. KARTH. And that perhaps, if we do as you suggest, is one thing that the committee ought to keep in mind during the course of tax reform.

Mr. BALL. I would think they might. I would not purport to be an expert on that.

Mr. KARTH. Thank you.

Mr. BURKE. Mr. Pickle.

Mr. PICKLE. Mr. Ball, it is good to talk with you. I have written you many letters over the years, and gnawed at you in a few instances, and discussed many things with you and others and it is nice to see you in the flesh and see that you really exist.

Mr. BALL. Maybe we had two automatic pens talking to each other.

Mr. PICKLE. I used to get a lot of pens when we were called to the White House to sign bills in those days. I still have some of them.

Let me ask you about the solvency of the funds. You are talking about the deficit and about what we should not allow. What kind of surplus should we have? What kind of safety valve should we have? What amount of funds should we keep on hand to give us some degree of solvency so that people will feel that the fund is in good shape?

Mr. BALL. I think this is a hard question to have an exact answer to, Mr. Pickle, but it might be helpful to the committee to talk of just a little history on this point with some comments on the future.

The 1971 Advisory council was the first one to frankly state a position in favor of pay-as-you-go financing with really dropping entirely the philosophy of even a partial earning reserve and saying instead the function of the trust funds should be just a contingency fund; in other words, just enough so that in a period like we are in now when it would be very bad economics to raise contribution rates right away that you don't have to, you can let that fund carry you for a few years.

They just happened to hit on the idea of 1 year's benefits, a fund equal to next year's benefit outgo. I was at the meeting where this occurred and I think that is because that is where the fund was and it was a nice rounded number. There was really no study of how long such a fund would carry you or how much one should carry you. We have a fund, I think, of maybe about two-thirds of next year's outgo now and it is clearly in my judgment more than we need, because even if you didn't take action until somewhere between 1979 and 1981 you still have this contingency fund which is enough and nobody, I think, would propose postponing action that long.

That leads me to say that I think the 1 year was higher than was needed and that I wouldn't urge that you build that fund up again to a full year's outgo.

But I think there would be a basis for concern if it gets, say, below a third or something of that kind of next year's outgo. What I would like to see is some real calculations made which, say, given a fund

of this size, with a benefit outgo in the following year of that size, what level of unemployment, what kind of a recession could that fund sustain for how long?

I would say a 3- or 4-year answer to that would be enough.

Mr. PICKLE. When we got the program underway good and it was at its peak, I suppose we had funds on hand for years of safety; didn't we?

Mr. BALL. That is true, but I think it was the accidental result of the fact that in the beginning, Mr. Pickle—

Mr. PICKLE. There was a sudden infusion of funds.

Mr. BALL. Also all during the early days of the program you had a relatively small proportion of people drawing out. We have only hit this 90 percent of all the aged you know fairly recently. If you charge any sizable contribution rate the funds are building during the early years.

Mr. PICKLE. It was bound to close the gap.

Mr. BALL. When you get to a more mature situation like the present it is different.

Mr. PICKLE. You say you don't need a full year's funds set aside, but less than a third would be too low.

Mr. BALL. I just pulled that out.

Mr. PICKLE. I am trying to see myself what the people would expect. I think the people are feeling that we have gone from a position of strength to a position that the funds are going to go broke within the next 3 years.

Mr. BALL. I think so.

Mr. PICKLE. And they also know and they are told, that they are actually paying benefits in the basis of payrolls that are being paid in that same year. It is less than a year now; is that right?

Mr. BALL. Yes.

Mr. PICKLE. So the people are bound to have the feeling of uncertainty and are scared of what is going to happen to the program.

If we just take the attitude of an actuary, the one-third of 1 year would be enough, I have a feeling that people are going to think that that fund is in great trouble, and we are going to have to be more conservative about it, or build up a little more. That is a personal feeling, I take it, from looking at it from the people's viewpoint rather than from what an actuary would say. I am concerned about that.

I am also concerned about the rate of benefits now in times of difficult economic conditions. We are hurt by inflation. We are hurt by the decoupling, or the condition that permits it. We are hurt by the oil embargo. Within the last year or two we have been seriously hurt.

What is to keep us from the same thing happening in the next year? Why aren't we going to be that much worse in the opposite direction? Is that a possibility?

Mr. BALL. Mr. Pickle, I don't think that a continuation of the level of inflation that we had a year or two ago combined with the level of unemployment, which has been the immediate cause of the social security difficulties, a realistic possibility over any significant period of time.

Mr. PICKLE. There is a real possibility of us continuing, isn't there?

Mr. BALL. If we go back to a 12- or 13-percent rate of inflation and maintain an 8- or 9-percent level of unemployment, then I just

don't really think you can plan the social security system given a continuation of such conditions. You guard yourself against that at a terrible cost.

Mr. PICKLE. We are in the type of situation that we have to guard against these types of things.

Mr. BALL. Maybe this would help. The proposals that I am making start to build the fund benefit at the rate of \$5 billion and \$6 billion a year beginning in 1978. It makes it even in 1977 and then it begins this new rate between 1985 and 1990 it would start building substantially again.

It would build and level off and build again. I was really only talking to how much it would build. I am agreeing that I think financing ought to be set up so that over the next 35 or 40 years there is a net growth in the fund year by year.

Mr. BURKE. Mr. Ball, if you will relax at that point, we will go out and vote and be right back.

[A recess was taken.]

Mr. BURKE. Now I think we can begin, Mr. Ball.

Is there anything you haven't covered now, Mr. Ball, that you would like to say?

Mr. BALL. Or forever hold your peace?

No, I have nothing else, Mr. Chairman.

Mr. BURKE. Yes. You know, I hold you in high regard, Mr. Ball, I really do. But I am a little disappointed, just a little. And I am disappointed with all the witnesses that have come in. Everybody comes in and says—and I am not criticizing you, believe me—everybody comes in here and says: Put the tax in effect in 1977.

If we were to raise the wage base, say from \$14,000 up to the \$17,000, it would mean that everybody earning over \$14,000 a year would pay about \$3 more a week in taxes.

Do you think that that would disrupt those people economically?

Mr. BALL. No, I don't Mr. Chairman. I think the effect of a relatively small increase in the wage base in 1976 which would have an effect in September of 1976 ought not to be significantly disruptive. And it would be an alternative to what I am suggesting by doing it by steps; that is, you might say \$17,000 in 1976, and then go to \$21,000 in 1977, and hit \$26,000 in 1978, say. So that you would have accomplished in three steps the equivalent.

Of course I am just making up the figures at the moment, but you would have three steps that were the equivalent in its financing effect on the social security system of \$24,000 in 1977. I think that would be a perfectly acceptable way to do it. I would like to defer to people who are much more familiar with the timing of the economic recovery than I am to whether they would be concerned about any increase at all in contributions in the fall of 1976.

I think it might turn out that they wouldn't. I was thinking when I was saying \$24,000 that that would be a very substantial impact as early as the fall of 1976. But the step idea might take most of the problem out of that.

Mr. BURKE. Well, I think that the increase to \$24,000 is something that we would have to do in a gradual way. But I can't understand why everybody that has come before this committee keeps saying let's increase the tax in 1977. You know from your experience before

the committee, and I think Mr. Myers' experience before the committee, despite what was said today, the Ways and Means Committee over the years always tries to have a dollar more coming in than is paid out of the fund.

Mr. BALL. Yes.

Mr. BURKE. And we always try to provide the revenue, despite all the criticism. When we voted for increases, we were sure that the funds were there, and if they weren't there we voted them with taxes.

Mr. BALL. That is the entire history, Mr. Chairman.

Mr. BURKE. I can't understand why everybody this year is shunning away from that principle, saying, well, let's not do anything for 2 years. They are talking about \$3 billion. We could raise \$3 billion if we just adjusted the wage base up to \$17,000, a little over \$17,000.

You know, it is not going to disrupt anything. In fact, it will give the Government a chance to have some more trust fund money that they can borrow, that they are going to borrow anyway. I don't see how it is going to disrupt the economy.

I think that what is bothering a lot of people is not the economic question. I think it is a political thinking and I think that it is where we have these problems with social security. If people could divorce themselves from the political aspects of it, and just deal with it in a realistic way—and say well, we know we are going to pay out so much money, so we have to raise that much money—instead of trying to be led by everybody. You know, this idea of voting for all the benefits and against all the taxes just won't work in the long run.

Mr. BALL. Well, Mr. Chairman, I could——

Mr. BURKE. Do you know what this country is facing? I have been watching my colleagues out there on the floor of the House, and on this energy bill. We have got votes out there for benefits, tax breaks—they win by something like 280 to about 85. They are for all the tax breaks and vote against all the increased taxes.

I think the trouble in the country is that we are living in a fantasy now and somebody, sometime, someplace, somewhere, has to grab the bull by the horns and say, look, we have to deal with social security. There are a hundred million people, almost, paying into this trust fund, who are concerned about the fact that they are being taxed every week, and they are paying into it and they are saying, "My God, when I retire there is not going to be any social security there for me."

Then there is the social security beneficiary who is receiving a check once a month, who is living in mortal fear that his check isn't going to continue to come.

It is about time that we in the Government did something to calm these people down and make this fund stable, and it could be done very quickly this year. We could do it in a half hour, in the committee, if we can just get somebody to come up here, you know, and take a strong stand.

Now, I am not asking you to do it, Mr. Ball; you are no longer the Commissioner. If you were, I might ask you to do it. And I am not going to ask my good friend Bob Myers to do it, but I think that is what our big problem is.

Everybody wants to put off the unpleasant things until 1977 and they want to be led by everybody. But you can't be led by everybody when you are scaring hell out of the old folks by having them feel

that their checks aren't going to be continued, and you are not going to be loved by everybody when the people paying the taxes week in and week out feel that that tax money is going to no avail.

Mr. BALL. You and I are in complete agreement, Mr. Chairman, that the Ways and Means Committee and the Congress as a whole have handled the social security financing system very responsibly. It has not in many other respects, but has not in this program voted benefits and then not wanted to vote the contribution.

I think it is very important, just as you do, that action be taken this year, and to be passed this year.

Now, it is a separate question to my mind, if you are going to raise the wage base as a part of doing it, at least a major part of doing it, there is only one issue there! Should part of it go into effect in 1976, or it all be postponed to 1977?

Either way I think it would reassure people if the legislation were passed this year, and the only way I said 1977 is that it is somewhat inconsistent from an economic standpoint to have stimulative features in the economic tax being pursued with refunds and then unbalancing the budget on purpose to stimulate the economy, if we more or less at the same time were making policy that was not stimulative in social security. But as I was saying, by the fall of 1977 it might work all right.

Mr. BURKE. Well, most of these people, Mr. Ball, that will be paying this tax received about a \$200 rebate, so we will be taking \$175 of it back, and they will have \$25 to stimulate the economy.

Mr. BALL. Stimulative effect.

Mr. BURKE. Talking about stimulative effects, the people have got all these rebate checks and I haven't seen any rush on department stores. I haven't got a report on any sales, other than the payments the elderly got—the \$50 checks. You might see some of those spent. They might go down and stock up on some groceries.

But I think that there have to be some responsible people some place around this country that will face up to the fact that we can't wait until 1977 to start doing things. Because as I see it they will have to come in with a request in January of 1977. From what they are doing out there, it is going to cost \$35 billion for the interest on the national debt. They are going to have a \$67 billion or \$70 billion deficit. They will lose \$2 million in interest on the social security trust fund alone.

With all these other things combined, I would say that by a conservative estimate they will have to come in and ask for an additional \$100 billion in taxes in January 1977. How would you like to be the President presenting that message to Congress in 1977? And a lot of it has been because they have been voting for every spending bill, voting for rebates and reduced taxes, and everything else. I don't know.

Well, I am chairman of this committee and they have handed me a lulu but I go back to my people in my district and I tell them I am in favor of increasing the taxes and making this social security trust fund sound. People come up to me and say that that is right, keep that social security fund sound. They want it. You could poll any group of people in this country and you will find that 90 percent of them want that social security system kept intact. And they don't want any fiddle-faddle go-round with it.

I think that is where all these politicians that think they are being loved by everybody are making the big mistake.

Mr. BALL. Mr. Chairman, there is another provision that has to do with the financing that you remind me of that I am very much in favor of. And that is taking the whole social security financing out of the general budget, and going back to the way it was handled up to fiscal year 1969 as a completely independent fund.

I would also like to see it set up as an independent agency reporting directly to the President. Mr. Mills introduced a bill like that last year, and Senator Church has had one both this year and last. I think that would be important.

Mr. BURKE. Both bills, it seems, have a lot of merit.

Well, Mr. Ball, thank you very much for your contribution.

The committee stands adjourned until tomorrow at 1 o'clock.

[Whereupon, at 4:05 p.m., the subcommittee was adjourned, to reconvene at 1 p.m., Thursday, June 19, 1975.]

FINANCING THE SOCIAL SECURITY SYSTEM

THURSDAY, JUNE 19, 1975

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON SOCIAL SECURITY
OF THE COMMITTEE ON WAYS AND MEANS,
Washington, D.C.

The subcommittee met at 1:10 p.m., pursuant to notice, in room H-208, the Capitol, Hon. James A. Burke (chairman of the subcommittee) presiding.

Mr. BURKE. The subcommittee will be in order. Our first witness here today is Wilbur J. Cohen, the former Secretary of Health, Education, and Welfare, who is well known to the committee.

We are glad to see you back and looking in such good shape. You may identify yourself for the record and proceed with your testimony.

STATEMENT OF WILBUR J. COHEN, DEAN, SCHOOL OF EDUCATION, UNIVERSITY OF MICHIGAN; PROFESSOR OF PUBLIC WELFARE ADMINISTRATION OF THE UNIVERSITY OF MICHIGAN; COCHAIRMAN OF THE INSTITUTE OF GERONTOLOGY OF THE UNIVERSITY OF MICHIGAN-WAYNE STATE UNIVERSITY; FORMER MEMBER OF THE BOARD OF TRUSTEES OF THE SOCIAL SECURITY SYSTEM; AND PRESIDENT OF THE AMERICAN PUBLIC WELFARE ASSOCIATION

Mr. COHEN. Thank you, Mr. Chairman.

I appear before you today in my capacity as professor of public welfare administration of the University of Michigan, cochairman of the Institute of Gerontology of the University of Michigan-Wayne State University, a former member of the board of trustees of the social security system, and the president of the American Public Welfare Association. I also claim to have been the first employee of the Social Security Board in 1935.

So I think I establish at least my seniority in connection with the subject, if nothing else.

Mr. Chairman, I would like to urge you as strongly as I can to enact legislation as promptly as possible to put the Social Security system on a sound financial basis. I recommend that the legislation be passed by the Congress this year, to be effective in 1977.

In my opinion it is vitally important that we allay the anxieties of people about the financial soundness of the Social Security system. It is essential that we take steps this year to assure that newspaper and magazine articles will not disturb and provoke uncertainty, distrust, and concern about the Government's stewardship, responsibility, and integrity of this important program which affects every person in the Nation.

I would like to say this, Mr. Chairman. I have been connected with the Social Security System in one way or another for 40 years, since I was a staff member of the President's Committee on Economic Security that drafted the original law, and I want to pay my respects to the Ways and Means Committee for its responsible action over those 40 years in keeping Social Security a financially sound institution. I say this, too, irrespective of who was chairman of this committee, from Mr. Doughton on, whether the committee was chaired by Republicans or Democrats. Your committee has had a record of financial integrity about the system, and I look upon the Ways and Means Committee and the Senate Finance Committee as the board of directors of the Social Security System.

I want to say that over these years I think you have an absolutely unparalleled record of keeping the system in good shape, no matter what the problems were, and I have complete confidence that you are going to take action now that will keep the system sound.

My own recommendation is that you increase the maximum earnings base to \$24,000 for 1977, with a transfer of part of the allocation from the medicare program to the OASDI program.

Now, Mr. Chairman, I have considered a number of alternatives. I think any general overall rate increase in the 5.85 percent would be undesirable in the immediate future. A rate increase would be in effect for all employees and all employers in the country.

I think of all of the alternatives that could be explored in what to do to handle the problem now, that is the least desirable alternative, and, therefore, I do not recommend that you take that option.

There are other possible ways of financing Social Security than the one I am recommending, or even the one about the general rate increase, or some combination thereof, although these all involve more debatable and controversial issues and hence may take a long time for you to consider and process.

I, therefore, urge you take the kind of steps which will produce the most prompt and effective action. The increase in the maximum earnings base that I have recommended has the advantage that it follows a sound and acceptable policy which the Congress has adopted on several different occasions. Therefore, the policy is one which is also well known, well understood, both with regard to its advantages and disadvantages.

There are, of course, objections not only to any increase in the maximum earnings base but also to any increase in the financing cost of the system. But each time the Congress has considered the problem of the maximum earnings base, it has rejected the objections which have been made to its increase. These objections may be summarized as follows:

An increase in the maximum earnings base curtails the scope of private pension plans and the roles of private insurance carriers, banks, trust companies, and the roles of investment in the stock market.

Second, it expands the role of the public sector.

Third, it increases the cost of business and to the individuals who have to pay for it.

I do not believe these objections are persuasive enough to have any substantial validity at this time in relation to the imperative need for

additional income to the Social Security System. These three types of objections have been reviewed and rejected by the Congress on nine different occasions and by distinguished advisory councils over the years on a number of occasions.

As a matter of fact, when you come to consider these items, the scope of private pension plans is being expanded partially as a result of recent legislation enacted by Congress, with the participation of this committee. As a matter of fact, the expansion of social security has tended to encourage the sale of private life insurance and retirement protection. Therefore, in conclusion, I think that a proper regard for both the private and public sectors, the private pension plans and social security, and the need for doing something now leads me to the inescapable conclusion that for the Congress the simplest, the easiest, the soundest, the most practical method is to increase the maximum earnings base.

However, I do recognize that any appreciable increase in the maximum earnings base at a given moment of time may have repercussions on business costs, adjustments in private pension plans, and on other factors. Consequently, a graduated increase may have some merit.

It should be noted that the first increase in the maximum earnings base in 1951 of \$3,600 from \$3,000 was 20 percent. The largest single dollar increase in 1 year was \$2,400 in 1965. It should also be noted that during the period 1971-75, the maximum earnings base increased from \$7,800 to \$14,000, an increase of \$5,300 in a 3-year period. So there has been a record of substantial increase, recognizing the increase in wages.

It should also be kept in mind, Mr. Chairman, that when Congress determined the original \$3,000 base in 1939, it intended at that time to cover somewhere between 90 and 95 percent of the total earnings of the individuals in the covered population at that time.

If the same principle, which I believe is sound, were to be applied today, it is clear that an earnings base of very substantially more than \$14,100 at the present time would be the effective limit in the law.

So, if you really wanted to get back to first principles, the principles of the original founding fathers of the system, you would be substantially above the \$14,000 at the present time.

Since, under present law, the maximum earnings base in 1977 is now estimated at approximately a level of \$16,500, using the economic assumptions that are contained in the 1975 trustees' report, a 20-percent increase would be about \$20,000. Thus an alternative possible schedule would be \$20,000 for employees in 1977; \$24,000 in 1978; \$28,000 in 1979, and \$30,000 for employees in 1980 and thereafter.

In addition, I recommend that whatever new maximum earnings base is established that as provided in present law the base be automatically adjusted to changing earnings conditions as provided in the present law.

Now, on that point, Mr. Chairman, if you follow the economic assumptions that were made in the 1975 trustees' report, it is estimated that by 1980 the maximum earnings base will be over \$20,000 by that time anyway—under the existing law.

I am informed by that time it may be as much as \$21,300 because of the automatic provisions in the present law.

So I believe that all that we are talking about now is no longer a matter of principle about whether the maximum ought to be increased, but to what extent and how fast.

I would also like to say that my own view is that the employer contribution to the system should not be limited to any earnings contribution maximum. The employer's entire payroll is the appropriate taxable base, as in workers' accident compensation, and as in many other types of insurance, and only the employee contribution should be limited by the amount of earnings which are included for benefit computation and contribution purposes.

I would like to, however, see return to 1939 level, Mr. Chairman, if it were possible. I don't know exactly what that limit would be in terms of present wages, but I know it's substantially more than \$14,100.

Now, in making this recommendation to you today, I just want to indicate that I did consider quite a number of different alternatives which I am not proposing to you today but which you well might want to consider.

One possibility which might be explored for the future is a change in the present 50-50 division of costs between the employer and employee. This policy established by this committee in 1935 has the great advantage of what Prof. J. Douglas Brown once called esthetic logic and it has great political appeal in trying to sell employers and employees to pay an equal amount; but, as a matter of fact, it doesn't have very much economic rationale.

So the 50-50 idea deserves careful reconsideration, in my opinion, by your subcommittee in the years ahead.

Now, why do I say that it doesn't have too much economic rationale?

The employee contribution, when it is made, is part of the taxable income of the individual. When the employee pays his contribution, he made it out of his gross income, and he gets no deduction for the employee contribution; but the employer contribution is deductible as a business expense, at least for corporations.

Since the corporation tax is nearly 50 percent, it can be argued that for corporations, the Federal Government and the general taxpayer pay about one-half of the employers' cost. To the extent that the employer shifts part of the contribution to higher prices, the consumer pays part of the cost. The employee contribution is borne solely and clearly by the employee plus whatever Federal and State income tax he must pay on his taxable income, of which that earnings was a part.

However, I do have to recognize that under the existing law, payments to the beneficiaries in terms of taxable income are not taxable under the present law.

It would be possible, in my opinion, to rationalize increasing the employer's share to two-thirds of the cost and reducing the employee's share to one-third of the cost. This could be done by steps over a 10-year period.

I am really directing my attention more to the longrun costs now, Mr. Chairman. In other words, if something like the actuary records show the eventual cost of the system is going to be 15 percent of the payroll, I could conceive of the situation where the employer would pay 5—the employee would pay 5, and the employer would pay 10

in that kind of a division, if it were a 15-percent cost system, with the employer still getting the reduction due to the fact that his contribution is a business expense.

That is only one way, an alternative way of handling the present system, and I will deal with others.

I do favor, Mr. Chairman, some general revenue financing for the social security system, but at an appropriate time. However, it will be virtually necessary to utilize substantial general revenue funds to finance low-income individuals in any national health insurance plan which this committee must consider and which I hope it will do in the near future.

Therefore, I would be conservative at this time, and I would allocate whatever additional general funds to the social security program were available for welfare reform and national health insurance.

I should like to point out, however, in making this point, general revenues are already utilized in the social security system. This is not a wholly new principle.

General revenues were authorized in 1965 by this committee to pay one-half of the cost of part B of medicare, providing for the physicians' services as part of the social security system. So we are not talking about a wholly new principle.

But I do think that when you consider general revenue financing, it is easier to consider it as part of a health program than it is in terms of the present system. Although I have for many years argued that, if a general Government contribution is to be brought into the system, you should use it to finance the actuarial cost—or I should put it this way, you should finance the difference between the cost of the benefits and the actuarial cost of the benefits to particular individuals, or what is sometimes called the "social adequacy" part of the benefit structure.

If I may illustrate that, let's say a person gets a minimum benefit of \$100, but the actuarial value of his contributions toward that was, let's say, \$60; \$40 is the social adequacy part of the benefit.

One could argue that that ought to be paid out of general revenues, and the employer-employee pay the so-called actuarial part of the benefit. That has a good deal of rationale to it.

However, I am reluctant to recommend that in any way now. I think that is a longer run proposition, and of these various alternatives, I therefore think raising maximum earnings base and reallocating amount from national health insurance system to OASI is the most practical way.

As you know, Mr. Chairman, the Congress included in the social security law of 1944 a provision known as the Vandenberg-Murray amendment, which provided as follows:

There is also authorized to be appropriated to the trust fund such additional sums as may be required to finance the benefits and payments provided under this title.

That was section 201(a) of the act. I think Mr. Mills and I would be the first to admit that we joined together in taking that out of the law in 1950, but I think, if I may say so, Mr. Mills, I think it was a mistake. I will take my share of the responsibility for supporting it. That Vandenberg-Murray amendment, if it had been in effect the last couple of years, would have helped us very substantially to overcome what I consider very undesirable propaganda against the integrity of the financing of the social security system.

That provision was never utilized, as you know, between 1944 and 1950. Nobody has any idea that it would be utilized in the future, but I do recommend that you reenact it as part of the law today, primarily to allay the anxiety and doubts which have been stimulated by the rash of publicity and propaganda against the financial integrity of the system.

No appropriation would have to be made under that amendment unless it were necessary, and no appropriation could be made without further action of the Congress, so you have plenty of control there. But such a sentence in the law would be a big help in removing concerns.

I would make one other argument. I cannot conceive, no matter what the financial difficulties of the present system are, or would be in the future, of Congress abdicating its financial responsibility under the system. And I don't think any Member of the Congress would stand up to say that, if the fund for any unknown reason were to be inadequate, or income to be inadequate to pay the benefits, that the benefits would be cut back.

Therefore, I think, putting the Vandenberg-Murray amendment into the law is simply recognizing not only the morality of the support for the integrity of the system, but the political reality of Congress' support for the system.

I also suggest that sometime you give consideration to an appropriate increase in the self-employment contribution rate, but allowing the self-employed individual to claim a deduction from their income tax of the amount equivalent to the employer contribution, just as an employer can do as a business expense if he is a business. This would equalize their situation with respect to other employers.

The reason for this is that the self-employed person is really a kind of a unique combination of an employer and an employee attribute, or both of them. It's kind of hard to say is he 50 percent employee, 50 percent employer; he's both; the self-employed person.

And we recognize that in the original law by setting the self-employed rate in effect at one and one-half times the employee rate; recognizing the differential in the benefit liability with regard to the self-employed.

I do think, though, that you might give some consideration to a change in that.

I also recommend that you extend the earned income credit enacted in the 1975 tax reduction law. This provision is effective only for 1975 in the present law.

Incidentally, Mr. Chairman, I find most people don't even know that it's in the law. I have done my own little public opinion poll, asking people about it, and I have yet to find one average person outside of Washington who knows that it's in the law.

It provides, as you know, a refund, or a tax credit, of 10 percent on earned income, which is approximately the combined employer-employee social security contribution to persons with dependents with earned income of \$4,000 a year or less. With a matching provision at \$4,000, it fades out at \$8,000. So that an earned income of \$4,000 with a dependent will get a \$400 refund this year, irrespective of other tax liability.

This provision, which incidentally was adopted by the Senate three times before it was included in the conference report, relieves many

low-income earners of a large part of the amount equivalent to what they pay in social security contributions. That is, it relieves them not only of their 5.85 percent which they paid, but a proportion of the employer's cost, which is really a deferred wage element anyway.

In my opinion, this provision which you put in the law, which I favor very strongly, is a rebuttal to the many charges that have been coming out particularly from economists that the social security contribution is regressive.

I disagree with these economists that the social security system is regressive. The social security system is not regressive when you take the taxes and the benefits and put them together.

But if you just look at the social security tax as a whole, of course, 5.85 percent on a person earning \$2,000 and earning \$14,000 is not progressive.

So I strongly urge you to extend this provision permanently in the law, or at least for a longer period of time, in order to relieve low-income people of the burden of the social security tax, which, of course, eventually must go up somewhat higher than it is today if we are going to have a financially sound system.

Now, Mr. Chairman, I am deeply concerned that many individuals today, particularly young people and women, do not realize the great economic-social value of the social security system.

The people who enacted the original law came out of the period of the depression of 1929-33 and valued the social security system as an important part of the new social fabric of our Nation. But some people today only see it as another form of tax. Some think of it as a savings system, erroneously. Some do not know it provides a monthly form of life insurance.

The total value of the life insurance in social security is equal to about all the private life insurance in the United States.

Or, of you put it another way, if you take all the life insurance in effect in the United States, half of it's social security and half of it's private.

I find many young people do not realize that there is a great, great value in the life insurance. When I told my son, after his second child was born, that he had a total of about \$70,000 to \$100,000 worth of life insurance in social security, like most young people he didn't believe me.

Of course, he doesn't believe his father on a lot of other things, too, but at least on that point I thought he would take my knowledge for granted.

But the fact of the matter is that very few people realize today that in social security they are not only paying for old age protection, they are paying for life insurance protection, they are paying for disability insurance protection, they are paying for health insurance protection.

Some do not realize that it includes disability insurance, and that the program helps more individuals mentally retarded at birth than any other such program in the United States.

Under an amendment adopted by this committee which provides that any child under the age of 18 who was mentally retarded at birth will be provided with benefits for the rest of their life, if their father or mother, who is eligible, is a retired or disabled individual, is completely taken care of in terms of benefit payments for a lifetime period.

Now, that's a great advantage to many parents of many families. But you can't find many people who know that. Some people think it only provides old age benefits. Most persons do not know that the social security program enables 700,000 persons age 18 to 22 to continue their education. It is one of the largest student financial aid programs in the Nation; 700,000 boys and girls continue to finish high school and go to college because of an amendment that this committee put in the law that permits young people who are the children of these beneficiaries to continue to get their benefits until age 22.

I believe that in the light of these financial problems that the social security system has today, we must do a much better job of informing the people of the costs, benefits, coverage, and value of this program.

I favor including in the envelope sending out the checks to the individuals that we include strictly factual information designed to inform beneficiaries about the facts of the program.

However, I wouldn't put that in the law until you convert the social security system to a board of three people, so that it would not at any time be subject to political manipulation.

I strongly favor the bills that are in Congress to transfer the Social Security Administration outside of HEW to an independent board, as it was in the original law proposed by this committee, which during the early periods maintained its political independence and nonpolitical character.

Many individuals do not know that the combined social security contribution of 5.85 percent goes for four different types of protection and that this protection includes millions of children, youths, and middle-aged persons in addition to the aged. I urge that you consider ways to overcome the misconceptions which are widespread about the system, in order that we have a better acceptance by people of paying the cost of the social security system.

The costs of social security are going to go up, Mr. Chairman. We all know that. I believe we must find a better way than we have so far of educating the American taxpayer, the American beneficiary, the American public, to the values of the program, so he and she will continue, as they have in the past, to be willing to pay.

You have got, in the way you have constructed the social security system, one of the great geniuses of Congressional action; namely, the workers of this country over the last 40 years have been willing to pay their social security taxes, they have been willing to pay every increase since it was 1 percent to 5.85 percent.

There has never been a time in the 40 years that I am aware of that any organized labor group came before this committee and objected to the raise in the social security tax to finance the benefit structure.

Now, I don't think you had that same experience in regard to other tax laws that you had before this committee. Now, there has been a magnificent contribution of the Congress and the executive branch in this system, that there has been a built-in consensus about the financial integrity of the system and the willingness to pay the cost. I would like to see that continued, but to continue it we have got to have the sympathetic understanding and full knowledge of the people that they are getting their money's worth.

I think you do get your money's worth out of the Social Security System. The program today with the benefit structure, plus the dynamic improvement of the benefits in relation to cost of living, gives everybody, in effect, their money's worth; gives everybody a sense of security; gives everybody, the community, the Nation, a sense of security. I think it's a great system.

I think it needs to be improved in many ways. I think you are going to improve it. But in order to improve it you have got to have the cooperation, the understanding, the willingness to pay the contributions and I think, therefore, we have got to do more about selling the American people the great values.

So I come up with one small suggestion.

I recommend that you amend the law to require that the W-2 form specifically state the proportions of the social security contributions which go to each risk. At the present time, Mr. Chairman, if you look at the W-2 form, it provides a little column up there which says F.I.C.A.

I am a teacher, and I asked my students, "What does F.I.C.A. mean?" Half of them don't know, and the other half said, "It means social security, but I don't know why." "I don't know how F.I.C.A. can mean social security."

Of course it means the Federal Insurance Contributions Act, which was put in the law by this committee.

I suggest that you write in the law a requirement making the Internal Revenue Service make the column read, "Social Security"; and then require on the form some kind of an explanation, something like this, with a change in the figures which I have to make them correct:

"Social security contribution, 75 percent goes for old age and survivors insurance; 10 percent for disability insurance; and 15 percent for medicare; the employer makes an equal contribution."

That is something which would make the individual both aware of what the cost is, aware that the employer is financing it and that there is more in the program than just old age.

In conclusion, Mr. Chairman, the social security system now pays benefits to 31 million persons, and that's going up every year. It won't be long till we are at 40 million and 50 million people paying benefits.

About 100 million persons make some contribution to the system each year as they go through the work force. The program, as you know, is one of the most efficiently administered programs in the Government. Its costs of administration compare favorably with any other system of similar type, public or private, not only in the United States but in the whole world.

It has always had excellent leadership ever since Mr. Altmeier was the first Commissioner of Social Security. The local offices, in my opinion, render efficient and compassionate services under great handicaps of limited personnel and salary increases.

The program and its administration need to be improved, in my opinion, in a number of respects. If we were considering that today, I would be glad to tell you how I would change it. But before, I recognize that before you can consider these important and far-reaching changes, you must restore the program to the kind of financial stability and soundness which it has always had in the past which will make it possible for the newspapers, magazines, radio and television to explain

the program in a way that will relieve the anxieties of these 31 million people who are drawing benefits, and the millions of people who expect to draw benefits in the next 5 or 10 years.

This is a very important task that you have, and as a former member of the board of trustees of the system, I urge you to take prompt action this year on financing of the program, even though the effective date on those changes in the financing have to be made in the future.

Thank you, Mr. Chairman.

[The prepared statement follows:]

IMPROVING THE FINANCING OF THE SOCIAL SECURITY SYSTEM

(By Wilbur J. Cohen, Secretary of Health, Education, and Welfare, 1968)

I appear before you today in my capacity as Professor of Public Welfare Administration of The University of Michigan, Co-Chairman of the Institute of Gerontology of The University of Michigan-Wayne State University, a former member of the Board of Trustees of the Social Security System, and the President of the American Public Welfare Association.

I urge you as strongly as I can to enact legislation as promptly as possible to put the social security system on a sound financial basis. I recommend that the legislation be passed by the Congress this year to be effective in 1977.

It is vitally important that we allay the anxieties of many people about the financial soundness of the social security system. It is essential that we take steps to assure that newspaper and magazine articles will not disburf and provoke uncertainty, distrust, and concern about the government's stewardship, responsibility, and integrity of this important program which affects every person in the Nation.

My recommendation is that you increase the maximum earnings base to \$24,000 for 1977, with a transfer of part of the allocation from the Medicare program to the OASDI program.

There are other possible ways of financing social security although these involve more debatable and controversial issues and hence may take more time to consider and process. I therefore suggest you take the steps which will produce the most prompt action. The increase in the maximum earnings base has the advantage that it follows a sound and acceptable policy which the Congress has adopted on several different occasions.

There are, of course, objections to any increase in the maximum earnings base which the Congress has considered each time but has rejected. These objections may be summarized as follows:

1. It curtails the scope of private pension plans and the role of private insurance carriers, banks, trust companies, and the role of investment in the stock market.
2. It expands the role of the public sector.
3. It increased the cost of business and to individuals.

I do not believe these objections are persuasive enough to have any substantial validity in relation to the imperative need for additional income to the social security system. These objections have been reviewed and rejected by the Congress on nine different occasions and by distinguished Advisory Councils on Social Security on several occasions. The scope of private pension plans is being expanded as a result of recent legislation enacted by this Committee. The expansion of social security has tended to encourage the sale of private life insurance and retirement protection.

However, it must be recognized that any appreciable increase in the maximum earnings base at a given moment of time may have repercussions on business costs, adjustments in private pension plans, and on other factors. Consequently, a graduated increase may have some merit. It should be noted that the first increase in 1951 of \$3,600 from \$3,000 was 20%. The largest single dollar increase in one year was \$2,400 in 1965. During the period 1971-75, the maximum earnings base increased from \$7,800 to \$14,000—an increase of \$5,300 in a three-year period.

Since under present law the maximum earnings base in 1977 is estimated at about \$16,500, a 20% increase would be about \$20,000. A possible schedule would be \$20,000 for employees in 1977; \$24,000 in 1978; \$28,000 in 1979 and \$30,000 for employees in 1980 and thereafter; with no maximum on the employer and the self-employed contribution after 1976.

In addition, I recommend that whatever new maximum earnings base is established that as provided in present law the base be *automatically* adjusted to changing earnings conditions as provided in the present law.

THE EMPLOYER CONTRIBUTION

My own view is that the employer contribution to the system should not be limited to any earnings contribution maximum. The employer's entire payroll is the appropriate taxable base (as in workers' accident compensation), and only the employee contribution should be limited by the amount of earnings which are included for benefit computation and contribution purposes.

CHANGE IN THE 50-50 DIVISION OF COSTS

One possibility which might be explored for the future is a change in the present 50-50 division of costs between the employer and employee. This policy has the great advantage of "aesthetic logic" and political appeal but not much economic rationale. It deserves careful reconsideration during the years ahead.

The employee contribution is part of taxable income while the employer contribution is deductible as a business cost. Since the corporation tax is nearly 50%, it can be argued that for corporations, the federal government and the general taxpayer pay about one-half of the employers' cost. To the extent the employer shifts part of the contribution to higher prices, the consumer pays part of the cost. The employee contribution is borne solely and clearly by the employee plus the federal and state income tax on his taxable income. However, the payments to the beneficiaries are not taxable under present law.

It would be possible to rationalize increasing the employer's share to $\frac{2}{3}$ of the cost and reducing the employee's share to $\frac{1}{3}$ of the cost. This could be done by steps over a ten-year period.

GENERAL REVENUES

I favor some general revenue financing for the social security system at an appropriate time. However, it will be virtually necessary to utilize substantial general revenue funds to finance low-income individuals in any national health insurance plan. Therefore, I would be conservative at this time in allocating additional general funds to the social security program and allocate available general revenue funds for welfare reform and national health insurance.

General revenues were authorized in 1965 to pay one-half of the cost of Part B of Medicare.

THE GOVERNMENT GUARANTEE

As you know, the Congress included in the social security law in 1944 a provision sponsored by Senator Vandenberg and Senator Murray, which provided as follows:

"There is also authorized to be appropriated to the Trust Fund such additional sums as may be required to finance the benefits and payments provided under this title (last sentence of section 201(a))."

This sentence was repealed in 1950. It never was utilized.

I recommend it be reenacted as part of the law primarily to allay the anxieties and doubts which have been stimulated by the current problems. No appropriation would have to be made unless it were necessary and no appropriation could be made without further action by the Congress. But such a sentence would be a big help in removing concerns.

THE SELF-EMPLOYED RATE

I suggest consideration be given to an appropriate increase in the self-employment contribution rate but allowing the self-employed to claim a deduction from their income tax of the amount equivalent to the employer contribution. This would equalize their situation with respect to other employers. Since the self-employed person is an unusual combination of employer and employee attributes, this would be a reasonable modification which would yield more income to the security system but with some reduction in federal income taxes.

EARNED INCOME CREDIT

I also recommend that you extend the earned income credit enacted in the 1975 tax reduction law. This provision is effective only for 1975 in the present law.

It provides, in effect, a refund of approximately the combined employer-employee social security contribution to persons with dependents with earned income of \$4,000 a year or less. It provides some refund up to nearly \$8,000 of earned income.

This provision relieves many low-income earners of a large part of the amount equivalent to what they pay in social security contributions. It is the rebuttal to the charge that the social security contribution is regressive.

I strongly urge the extension of this provision.

COST, BENEFITS, VALUES

I am deeply concerned that many individuals today, particularly young people and women, do not realize the great value of the social security program. Some only see it as another form of tax. Some see it as a savings system. Some do not know it provides a form of monthly life insurance, the total face value which is equal to all the private life insurance in force in the United States. Some do not realize it includes disability insurance and that the program helps more individuals mentally retarded at birth than any other such program in the United States. Some think it only provides old age benefits. Most persons do not know that the social security program enables 700,000 persons age 18-22 to continue their education. It is one of the largest student-aid programs in the nation. We must do a much better job of informing people of the costs, benefits, coverage and value of the entire program. I strongly favor inclusion in the envelope sending the checks to individuals strictly factual information designed to inform beneficiaries of the facts about the program.

Many individuals do not know that the combined social security contribution of 5.85% goes for four different types of protection and that this protection includes children, youths, and middle-aged persons in addition to the aged. I urge that you consider ways to overcome the misconceptions which are widespread about the system.

EDUCATING THE PUBLIC

I recommend that you amend the law to require that the W-2 form specifically state the portion of the social security contributions which go to each risk. At the present time all the W-2 form provides is the total employee deduction for "FICA." The vast majority of taxpayers do not even know what these initials mean! I suggest changing the law to make the column read: "Social Security" and then require an explanation on the form something like this: Social security contribution: 70% goes for old age and survivors insurance protection; 15% for disability insurance; and 10% for Medicare. The employer makes an equal contribution.

CONCLUSION

The social security system now pays benefits to 31 million persons. About 100 million persons make some contribution to the system each year.

The program is one of the most efficiently administered programs in government. It has always had excellent leadership. The local offices render efficient and compassionate services under great handicaps.

The program and its administration need to be improved in a number of important respects. Before you can consider these changes you must restore the program to the kind of financial stability and soundness which will make it possible for the newspapers, magazines, radio and television to explain the program in a way which will relieve anxieties.

This is a very important task. As a former member of the Board of Trustees of the system, I urge you to take prompt action on the financing of the program.

MR. BURKE. Thank you, Mr. Cohen.

As usual, you have made an excellent statement. You have covered the problem of financing very well, and have made some recommendations that should be considered.

MR. COTTER.

MR. COTTER. I just have one short question, Mr. Chairman.

MR. COHEN, I want to congratulate you on a well-prepared statement, in which you have suggested that the employees' tax be made deductible.

MR. COHEN. The employer's.

Mr. COTTER. Employees, or employers as well?

Mr. COHEN. I am sorry; I misspoke.

Mr. COTTER. The employer's is.

Mr. COHEN. Yes.

Mr. COTTER. Yes.

Mr. COHEN. I suggested that, if you are going to increase the employer contribution, you make it partially deductible, yes, sir.

Mr. COTTER. Not the employees?

Mr. COHEN. Well, let me put it this way—

Mr. JONES. You were talking about the self-employed.

Mr. COHEN. The employer's is already deductible; I misspoke.

Mr. COTTER. Yes.

Mr. JONES. You were talking about the self-employed.

Mr. COHEN. Yes; let's start with the self-employed; don't get confused. I was speaking at that point about the self-employed. When the self-employed pays \$1,000 now as self-employed, that's all out of his gross income; he gets no tax deduction for that at all.

Mr. COTTER. Right.

Mr. COHEN. I was suggesting as that goes up, which becomes a more onerous responsibility, that you might consider, I said, in taking it what would otherwise be the employer share, that is, the 5.85, and giving him a tax deduction for that; yes.

Mr. COTTER. Do you have any idea what the revenue loss would be for allowing the self-employed to deduct one-half of their payment?

Mr. COHEN. I don't have it right at hand, no, sir.

Mr. COTTER. But this is just in the case of the self-employed, right?

Mr. COHEN. That was the only point I was recommending at that point there. You see you are going to get a situation, the reason I brought that up, of course you have problems with tax costs no matter who pays it, but the self-employed contribution, as you go up in the rate particularly, becomes a pretty substantial amount of money.

I thought I would locate it here very easily. But if you should eventually get up to, let's say, 6 or 7 percent as a rate, and you have the 150 percent rate for the self-employed, 7 percent, that would be 10½ percent; you are going to get some rebellion from those self-employed people, and I was trying to think of some way that, as the rate went up, you could moderate that impact upon them.

Mr. COTTER. What proportion of the total number contributing to the system does the self-employed represent, do you know?

Mr. COHEN. The self-employed?

Mr. COTTER. Yes.

Mr. COHEN. I don't have that figure right with me, but of course it's not a large proportion, because employees—you also have to keep in mind this point, the way the tax system works. For many people who are both employees and self-employed, once they reach \$14,100 of employment tax, there is no self-employment tax on them, even though they are self-employed.

Do you understand what I mean?

There are a lot of persons who draw both. If you are an employee of a corporation and a director, let's say you have both employee income and self-employment, you never get tax on self-employment income, because first the thing you deduct is \$14,100 as an employee, so you would really have to study it.

The staff could get that for you from the Social Security Administration.

Mr. COTTER. Thank you very much.

That is all I have.

Mr. BURKE. Mr. Jones.

Mr. JONES. Thank you, Mr. Chairman.

I, too want to commend Mr. Cohen not only for his testimony, but for his great dedication to social causes, and to this particular social security system.

Let me see if I understand. For the immediate problem, all you are suggesting that this Congress do this year or next, to become effective in 1977, is to raise the earnings base to \$24,000?

Mr. COHEN. That would be the simplest, Mr. Jones; yes. And then make it automatic, as the present law does, thereafter.

Mr. JONES. Now, some witnesses that appeared here in commenting on that recommendation say all you are doing is postponing the more difficult problem down the road. Now, what's your comment to that?

Mr. COHEN. Well, we do have a financial problem about the social security system down the road, and I think Congress ought to go into it. But that is not an immediate problem. You have got 5 to 10 years to deal with that problem, and I recommend that you do it.

But to solve the long-run problem and the short-run problem, it would seem to me, delay your solution to the long-run problem and, as I say, to keep people——

Mr. JONES. Well, the people who say that, say that you are really just exacerbating the long-run problem, and that you should have a slight increase in the tax instead of——

Mr. COHEN. Well, I don't happen to agree with that. We have increased the tax rates considerably since they were 1 percent. We are up to 5.85 percent, and we have increased the wage base from \$3,000 to \$14,100. So far, we have done both of those.

I think now it would be desirable, more desirable, to increase the maximum earnings base in the short-run. When you come to the long-run, I don't favor substantially increasing the 5.85 percent on employees. I think you have got to find other substitutes.

Now, why do I feel that, Mr. Jones?

I think you are going to adopt a national health insurance plan in the future.

Mr. JONES. At that point, do you see taking medicare out of the trust fund entirely?

Mr. COHEN. No, sir; perhaps I don't understand your point. You mean paying it all out of general revenue?

Mr. JONES. Right.

Mr. COHEN. No, sir; I would be violently opposed to that.

Mr. BURKE. I think we will have to recess. The second bell has rung.

Do you want to continue your questioning?

Mr. JONES. How much time do we have?

Mr. BURKE. If you will wait here until we come back.

Mr. COHEN. Certainly.

[A recess was taken.]

Mr. BURKE. The committee will be in order.

Mr. Cohen.

Mr. COHEN. Should I just finish answering Mr. Jones' question?

Mr. BURKE. We will keep the record open.

Mr. COHEN. I will just finish it for the record.

Mr. BURKE. Yes.

Mr. COHEN. Mr. Jones asked if I favor the recommendation made by the majority of the Advisory Council on Social Security that the medicare program be financed entirely out of general revenue. My answer was: No; I am vigorously opposed to that recommendation as being basically unsound and undesirable.

I believe that every benefit should have a contributory element in it; that is, every benefit should have some employer-employee contribution toward it so that the benefit continues as a matter of statutory right. Once you take a whole benefit and make it financed out of general revenue, you are going to have some kind of immediate public issue over it, as veterans' benefits and food stamps, and everything else. Congress is going to decide each year whether it should increase or decrease or change it.

The value of a contributory social security system with the employer and employee contributing part of the cost is that the beneficiary knows that he has got as good a guaranteed right to benefit by a statutory provision as man can make it. There is no absolute certainty in this world, but insofar as Congress is able to say to a person you are going to be sure you get this, the backbone for that, the background for that is that the employer and employee have contributed toward it, and Congress will therefore recognize that statutory right.

Therefore, I am opposed very vigorously to the recommendation made by the majority of the Advisory Council.

Mr. BURKE. Thank you. Now, with reference to the benefits that are paid, how would you make a breakdown of what part of the social security benefits come under welfare and what part comes under social insurance?

Mr. COHEN. Well, if I were to have to make, I would prefer, instead of calling it welfare, to call it the social adequacy part of it, instead of the benefit part of it. And those are not my terms; those are terms invented by Reinhardt Wholehouse, the actuary of Metropolitan Life Insurance Co. in 1937 or so, a very great man.

Generally speaking, my concept of the social adequacy part of the benefit is that part of the cost of the benefits that are not paid for by the employer-employee contribution while the system is still immature, or what in private pension plans would be called the liability that is created by putting a system into effect, by paying full-rate benefits before people have a full lifetime to contribute.

It is my understanding, although you can verify this from other sources, my understanding is based upon some 5 or 6 years ago, or 7 years ago, when I was Secretary, that that social adequacy part is about a third of the long-run cost of the benefits.

Mr. BURKE. So there is almost a moral obligation on the part of the Federal Government to pay for some of that out of general revenue rather than have the trust fund carry the full load?

Mr. COHEN. Well, that is a debatable question. I think that there is a good case for that, Mr. Burke, and I think that would be the basis for the bill which you introduced which provides, as I recall, one-third for Federal Government financing; does it not?

Mr. BURKE. My bill reduces the tax rate for employer and employee to 3.9 percent and provides that one-third of the trust fund receipts come from general revenues.

Mr. COHEN. Well, in general, the concept of what I would call a tripartite system, equal financing by the employer, the employee, and the Federal Government, can roughly be justified on the philosophy that I have just indicated, that in the long run, over a 100 years or so, the costs of the social adequacy part of the benefits would be roughly a third of the costs.

So you come back to my point that I made. If according to these estimates the system is going to cost about 15 percent of payroll in about, I forget, 25 or 50 years, it then could be financed on a 5, 5, and 5 equal-partite basis. That would be logical, that would be intelligible, and it would have a good deal of merit. I don't think you have to do it today, though, Mr. Burke.

Mr. BURKE. I am not for moving too fast on it. I am making a gradual movement in this direction, and I am waiting until I get 219 cosponsors. I have 135 right now, and we are not being too aggressive about it this year because of budgetary problems and the rebates and everything else that they put out slowed us down a little bit.

I can tell you the sun will come up tomorrow morning if it doesn't rain, and maybe I am a little ahead of my time. But in your experience in the years that you were Secretary of HEW and in other positions you have had a chance to observe some of the countries that have this system. It seems they don't have any real problems over there, do they?

Mr. COHEN. Well, let me say, every country in the world——

Mr. BURKE. I know that they have some problems.

Mr. COHEN. Every country in the world has problems. These types of systems are now about 75 years old, more or less, and every country and every public and private pension plan has had one pervasive problem, and that has been inflation, whether it was Germany in the twenties, or our country now, or England now, or Turkey or Israel, all who have higher inflation than we do. So they have had their problems.

And that is one of the reasons why you a couple of years ago indexed the benefits of the social security system, and in fact indexed both the maximum earnings base and the retirement test. I think those were very sensible, intelligent, sound proposals.

But it will take recurrent reevaluations of the financial aspects of the program to be sure you keep it on a sound basis. Whatever those problems are, they are problems as well of private pension plans as well as public pension plans. I think that we have got to look at that overall if we are going to see that older people have financial security rising out of the social security, private pensions, the supplemental income, homeownership, and private savings. Those are the five prongs of old age security in this country.

Mr. BURKE. Well, I appreciate your remarks about what the committee has done over the years, as you were here, and as I always recall, at the time we did increase benefits we provided the revenue to do it.

Mr. COHEN. Yes, sir.

Mr. BURKE. In fact, I remember the former chairman always insisted on having a dollar more coming into the fund than they paid out. But of course we are in unique times right now. We have been caught with this sudden inflation and recession at the same time and this committee has to take some steps.

I don't know, I am having a little difficulty selling the idea of doing something in 1976. Everybody would like to wait until 1977.

I think that while the inflation is going on we have to have inflation in revenue also, because if conditions continue we might be in a worse position than they predict. In fact, I keep getting reports that we might run out of money before 1981, and if that ever happens God help us, you know, if we have allowed a couple of years to slip by us without taking advantage of it. And the proposals I am suggesting, I don't see how they will upset the economy. It is just going to nibble from people in the higher wage bracket, take a little bit back from those that we gave rebates to. I think it would cost about \$175 and they got \$200 rebates, so they will only have \$25 to help the economy.

Mr. COHEN. Well, you could do it in steps, Mr. Burke, following out your idea and mine, if you want to do something in 1976 when it is going to be \$16,500 anyway, probably. No, it will be, the estimate for 1976 is \$15,000, under the automatic provisions, and \$16,500. You certainly could go up another thousand dollars in each of those, if you wanted to, in the near years, and then 1978, 1979, and 1980 go up a little faster. There are alternative ways of doing that.

My only reason for suggesting deferral to 1977 is actually while the trust fund would go down, under my proposal, whereas the assets in the old age and survivors and disability insurance fund at the end of 1977 under the present law would be \$31 billion, they would be \$36 billion under my proposal, and climb to \$55 billion by 1980, which would be slightly more than the \$45 billion they were at the end of 1974.

So I think the only difference is how fast do you get back to restoring the reserve to approximately where it was before. You can do it two, three, four different ways.

Mr. BURKE. Oh, yes. We had some testimony here that indicated that the reserve didn't have to be as high as that; it could be down to one-third of what it formerly was.

Then of course if that happened, you would have some people coming in saying, well, the one-third isn't necessary, you could bring it down to zero. Then you would have some people coming in later on saying, in fact, no funds are in there, you could have a deficit for 6 months. Then the first thing you know you would have no social security.

Mr. COHEN. Well, I don't favor that at all, Mr. Burke. I am strongly opposed to that.

Mr. BURKE. Well, I mean these are things that bother me. You know, I am a liberal, I am supposed to be a liberal, and I try to be liberal in my way. But I can't see this voting for all the spending bills and not to providing the revenue. This is what bothers me about the social security trust fund.

A lot of people are making all these rash statements. It is unfortunate. They are putting them out, and everybody I hear from around here keeps coming in here before the committee and they keep telling us, well, put these taxes in effect in 1977. They are saying to the Members of Congress, "You don't want to make any real decisions this year that people can find out about until after the November elections in 1976," and then the administration won't have to worry about it because people won't find out about that tax bite until after November 1976.

I think we ought to sweep that kind of thinking aside and really get down and grab the bull by the horns and do what we have to do, which

we are going to do. We will have to do it in 1977 anyway. We will have to do it by that time, or conditions will be chaotic.

But everybody keeps hitting that 1977 figure, and it almost sounds like it is an orchestrated figure.

Mr. COHEN. No; I will tell you why.

Mr. BURKE. You wonder why somebody doesn't come in here and say 1976. But everybody likes that magic year of 1977. I feel like I am out here alone. You know I have got my good friend Bill Cotter here, who stands with me 99 percent of the way, but 1 percent I know——

Mr. COTTER. Give me a little leeway.

Mr. BURKE. Leeway. I think we have to deal with the problem now as it is. I don't think we can keep procrastinating or postponing what has to be done.

Mr. COHEN. Well, you are only talking about 1 year.

Mr. BURKE. I wish somebody could come in here and stand up and say this, and then I would go home tonight and sleep a lot better. I have difficulty at night; it takes me 5 minutes now to go to sleep.

Mr. COHEN. I guarantee you, Mr. Burke, you get the Ways and Means Committee to put it in in 1976 and I will support it.

Mr. BURKE. No; I can't get a majority. I can't. I am telling you, I don't find any support around at all. I feel like I am a voice in the wilderness. In fact, I hope that before these hearings are over that some courageous man will come over and join me. If I ever write a book on profiles in courage, if he does that I will give him a paragraph in that book.

Mr. COHEN. You understand that the maximum earnings base is going to go up next year anyway. I mean, it is going to go up.

Mr. BURKE. Yes; but the deficits that are projected are taking those figures into consideration.

Mr. COHEN. Yes; that is correct, they have. But you still at the end of 1975 will have \$43 billion in the trust fund.

Mr. BURKE. Maybe we will.

Mr. COHEN. Well, if you don't have \$43 billion you are going to have \$42 billion, so I don't think that is worth arguing about.

Mr. BURKE. You might have \$40 billion.

Mr. COHEN. Well, \$40 billion, let's say \$35 billion, you still have got plenty.

Mr. BURKE. How would you like to be running a business firm and have \$43 billion in the bank, say, for borrowing at 7 percent interest, and then have it drop to \$40 billion and lose 7 percent interest on that \$3 billion?

Mr. COHEN. Well, if I were in a private business, I wouldn't like it; but if you are the Government——

Mr. BURKE. You would never allow it. You would never allow it to happen.

Mr. COHEN. But that is the difference between private enterprise and the Government. You are making an erroneous analogy between the way the Government can operate the system—the Government doesn't have to worry about a year-by-year situation in social security. All you have to be sure is that the program is financed soundly over a period of time, the calendar year.

Mr. BURKE. But the money that is in there should be earning money.

Mr. COHEN. It does.

Mr. BURKE. It does; and the lower it gets, the less money it earns.

Mr. COHEN. That is correct.

Mr. BURKE. Which detracts from the amount of money that can be paid out in benefits and stabilizes the fund.

Mr. COHEN. I agree with that.

Mr. COTTER. Will the gentleman yield?

Mr. BURKE. Yes.

Mr. COTTER. Mr. Cohen, at what level do you think that the fund should be maintained?

Mr. COHEN. Well, I think approximately 1 year of benefits.

Mr. COTTER. Well, aren't we below that?

Mr. COHEN. Oh, we are way below that; yes, sir.

Mr. COTTER. Yes.

Mr. COHEN. But under my proposal you would start getting back to that. Under my proposal, by 1980 you would be at \$55 billion, which would be 41 percent of benefits in that year. In other words, we would still be substantially below. We were at 73 percent at the end of 1974. We estimate we will be at 66 percent in 1975; 55 percent in 1976, and 42 percent in 1977.

I want to try to keep where we are and then hope to build back in the future.

Mr. COTTER. It is pretty difficult to build back, isn't it?

Mr. COHEN. No.

Mr. BURKE. Did you want to finish those figures?

And 42 percent in 1977, 32 percent in 1978, 24 percent in 1979, and 16 percent in 1980.

Mr. COHEN. Yes. But under mine——

Mr. BURKE. Now, that is only 5 years away.

Mr. COHEN. Yes; but that is if you don't accept my recommendation. If you accept my recommendation, you get back up to 41 percent. Now, I agree that that isn't 100 percent, and I would be glad to proceed at a faster rate if it were feasible. But my testimony today was: Solve the shortrun problem this year, in the legislation, and then go into your consideration of the longrun financing.

I agree with you, Mr. Burke, that something has to be done on the longrun financing of the system, and I am perfectly willing that you do that and that you find the finances to do it. But I am so eager to get the short-range thing so that these newspaper articles and magazines will not undermine the confidence that people have in the system. That seems to me to be so much more important than what the reserve is going to be in 1981.

I want to be able to go out on the 40th anniversary of this act, which is on August 14 of this year, and say Congress has enacted a law which assures that there will be adequate money in the trust funds for the next 20 or 30 years, or whatever it is, to pay the benefits of this system.

I can't say that now, because of just what you pointed out. So I would like to divide these two questions. The current shortrun thing, take care of that right away; the simplest, easiest, fastest way you can get Congress to do it. Then go into the longrun thing, make whatever changes you want along the lines of your bill, or anything else. That is going to take you a long time.

Mr. BURKE. Well, as I point out to you, the shortrun problem should be taken care of, and should be taken care of forthwith.

Mr. COHEN. Yes.

Mr. BURKE. But nobody wants to take care of it until 1977.

Mr. COHEN. Well, that is the short run, in my opinion, by 1977.

Mr. BURKE. Well, it might be short run, but it is not a responsible way of doing it.

Mr. COHEN. No, but 19—

Mr. BURKE. Everybody knows that we have to raise those revenues in 1977. If they start raising them now, we will have to raise less revenues in 1977 if we start raising them in 1976. That is what I am getting at.

When you postpone it a year, you lose all those revenues for that year; then you have to make up what you did the year before, which increases the taxes that you will have to ask for.

Mr. COHEN. Well, take my other alternative then; raise it in 1976 to \$20,000, like I suggested. Go up in steps. Go to \$20,000 right off the bat, instead of \$16,500 or \$15,000; whatever figure you want. Then go up to \$24,000; \$26,000; \$28,000; and you can do it in those steps and come to the same end.

Mr. BURKE. All right.

Mr. COHEN. I think that it is perfectly reasonable.

Mr. BURKE. I think you have made some good recommendations here, and you stuck your neck out a little farther than most people, even if maybe not as far as I would have liked you to stick it out.

Mr. COHEN. Well, I have had it chopped off many times, Mr. Burke, so I know how it feels.

Mr. BURKE. But you have been an excellent witness and the committee appreciates your appearance.

Mr. COHEN. Thank you.

Mr. COTTER. Thank you, Mr. Cohen.

Mr. COHEN. Mr. Jones, I answered your question on the record while you were out.

Mr. JONES. Most of my questions were on the long-range problems and we can visit on that later.

Mr. COHEN. Yes. Thank you.

Mr. BURKE. Our next witness is from the National Association of Manufacturers, Mr. Walter E. Klint, member of employee benefits committee.

Is Mr. Klint here?

Mr. KLINT. Here.

Mr. BURKE. We welcome you to the committee. You may identify yourself and proceed with your statement.

STATEMENT OF WALTER E. KLINT, DIRECTOR, EMPLOYEE BENEFIT PROGRAMS, CONTINENTAL CAN CO., MEMBER, EMPLOYEE BENEFITS COMMITTEE, NATIONAL ASSOCIATION OF MANUFACTURERS; DR. ROBERT MYERS, CONSULTANT TO NAM; RANDOLPH HALE, ASSISTANT VICE PRESIDENT AND MANAGER, INDUSTRIAL RELATIONS DEPARTMENT; AND BRENDA BALLARD, ASSISTANT DIRECTOR OF EMPLOYEE BENEFITS

Mr. KLINT. Thank you, Mr. Chairman.

My name is Walter Klint and I am director of employee benefit programs for Continental Can Co. in New York. With me today are Dr. Robert Myers, whom you know, and who serves as a consultant to the NAM; also Randolph Hale, assistant vice president and manager of the industrial relations department; and Brenda Ballard, assistant director of employee benefits.

I welcome the opportunity to appear on behalf of the National Association of Manufacturers, which is a voluntary, nonprofit business organization with membership of over 13,000 employers. As chairman of the NAM social security task force, I am here today to speak for American industry.

And, may I remind you that we are your biggest single source of revenue for the social security system.

We can appreciate the difficulty in arriving at a financing solution to social security which will be welcomed by all. In view of the complexity of the problem, I would like to preface my comments by emphasizing two underlying fundamentals which the association believes should remain constant in any discussion of the social security program.

First, we must not lose sight of the fact that social security functions through a transfer of money from one generation to another. In other words, the entire system is based upon the ability of productive employees and their employers to finance the benefits of today's elderly, the disabled, and the survivors of deceased employees. Therefore, the cost to finance these benefits must be equitably and responsibly shared by our productive employees and their employers.

The second point we would like to emphasize is that social security should provide a floor of protection, not a full replacement of earnings. The balance of the economic security needs of our citizens should desirably come through the private sector, with a backstop of public assistance for those whose needs are not met fully by social security plus other sources.

With these two fundamentals in mind, the NAM makes the following recommendations.

We think immediate action is needed now, Mr. Chairman, not in 1977. In a recent editorial, *The Wall Street Journal* warned that the social security program may be heading toward the same financial disaster which now faces our city—or my city, at least—of New York, because no one in authority seems particularly worried.

This comment seems to us to be unfair. Obviously, those in authority are concerned with the problems of social security, such as Chairman Burke has outlined here this afternoon. We must point out, however, that mere concern, without concurrent action, may serve to speed along the editorial's gloomy prophecy.

The 1975 Social Security OASDI Trustees Report shows that, in this year alone, social security expenditures will exceed income by about \$3 billion. What is more, current estimates show that, under present law, outgo will exceed income in each future year. It is obvious that unless something is done to alter this course, the social security system will become insolvent. The important question to consider is this: How much time do we have before the OASI and DI trust funds are exhausted?

The first two tables in the appendix to this statement illustrate the importance of expeditious action.

Table 1 shows the status of the OASI and DI trust funds over the next 9 years, based on estimates presented in the 1975 trustees report. The extension beyond 1979 has been estimated by Dr. Myers, who used the same economic assumptions as used by the trustees. As you can see from this table, the OASI trust fund would be exhausted in late 1981, and the excess of outgo over income in 1983 would be as

much as \$16 billion. The disability insurance trust fund would be exhausted in early 1980, with the excess of outgo over income being as much \$4 billion in 1983.

Now let's suppose that the projections in the 1975 trustees report understate the financing problem, because the economic assumptions as to price and wage increases are overly optimistic. The NAM concurs with Bob Myers' belief that this is a reasonable supposition, since the trustees assume that in 1976 to 1980 the annual rate of increase in wages will exceed the annual rate of increase in prices by about 3 percent each year—exactly the reverse of the situation in recent years and substantially more than what this differential has been in recent decades.

Table 2 of the appendix presents the status of the OASI and DI trust funds over the next 9 years, based on what we think are more realistic assumptions as to future price and wage changes. Specifically, the assumptions in this table are those used in the trustees report but modified as follows:

1. No change in the rate of increase in earnings, and
2. The rate of increase in the consumer price index is only 1 percent less than the rate of increase in earnings in 1976 and only 2 percent less in the following years.

If these assumptions are valid—and they are assumptions—the OASI trust fund would be exhausted in 1980, and the excess of outgo over income in 1983 would be as much as \$26 billion. The disability trust fund would be exhausted in mid-1979, and the excess of outgo over income would be as much as \$5 billion in 1983.

It goes without saying that the longer we delay taking action to remedy these short-term deficits, the greater the risk grows that the problem will become insolvable.

How we are going to increase social security revenue is the major question.

Studies on social security have resulted in a number of proposals for increasing the cash flow into the system. Before presenting NAM's position, I would like to address myself to those recommendations which the association cannot support, and briefly explain why.

It has been proposed that a much higher taxable earnings base than the present \$14,100 would be a desirable way to solve at least part of the financing problem. The NAM cannot support this proposal. The maximum taxable earnings base should not be used as a short range "convenience" financing mechanism; rather it should only be kept up to date with changes in average covered wage levels, as is done now by the automatic-adjustment provisions. To those who advocate a substantial and arbitrary increase in the taxable earnings base, we would point out that this approach produces relatively little additional revenue at the present time. Now, let me shock you a little bit. As a matter of fact, even if the maximum earnings base were to be doubled from \$14,100 to \$28,200, the additional revenue produced would probably be less than a 0.5-percent increase in the rates of both the employee and the employer tax on the present maximum wage base.

And what is more, such an increase would be inequitable because the additional tax burden placed on higher paid employees would far outweigh the increase in their benefits. In addition, and I don't think anybody has thought of this, such arbitrary action would have a little known but serious long-range impact on the recently created

Pension Benefit Guaranty Corporation under the Employee Retirement Income Security Act of 1974. Under the law, such an increase would require the Corporation to increase the maximum insured private pension benefit from the \$750 per month, where it is today, to over \$1,600 per month.

Now, the number of other alarm clocks and barometers around Washington which are geared to the social security maximum wage base, I don't know; but I can only presume there are others.

The second proposal which the NAM must oppose is a subsidy from general revenues—either directly or indirectly. Many people erroneously believe that money from general revenues comes from taxes that someone else paid. This, of course, simply isn't true. Consequently, the use of general revenues to finance social security is, at best, deceptive. If the participants are able to see their own tax rates with high visibility, we sincerely believe that they will be much more inclined to favor realistic limits to the program, the ones that we can afford.

The NAM takes the position that the most responsible and equitable means of providing the needed flow of cash over the short-range would be two modest increases in the present tax rate.

Although the 1975 Trustees Report shows an estimated long-range deficit of 5.32 percent of taxable payroll, we do not believe that such a huge increase in the tax rate needs to be made at the present time. Mr. Chairman, we propose, therefore, that a total 1-percent increase in the tax rate—0.5 percent employer, 0.5 employee—be legislated for no later than 1976.

Now, this may sound heretic to some of my contemporaries, but I am sitting before you representing 13,000 employers and I am recommending an increase in our tax rate, and as quickly as possible, to maintain the solvency of this program. And we did secure the unanimity of opinion of many very large corporations before this position was taken.

Now, in analyzing the problem of maintaining the system's fiscal solvency, gentlemen, we have been simply unable to separate the mechanism for feeding money into the system from the method of determining outgo. Each is equally important. Therefore, we believe that our proposal of increases in the tax rate must be tied to a revamping of the method of computing initial old-age benefit awards.

By that we mean decoupling social security benefits. When the automatic-adjustment provisions governing the calculation of benefit amounts for new retirees were enacted in 1972, the objective of Congress was to establish a means whereby benefit amounts would keep pace with increases in wages and prices.

It has now become apparent that the automatic-adjustment provisions will very probably create great instability in the results of benefit computations and concomitant instability in the program's financing. If wages and prices rise at approximately the same rate, and if that rate is relatively high—and under today's conditions this is not an unreasonable assumption—the benefits awarded each year in the future will represent higher and higher, and ultimately prohibitive percentages of final earnings.

At a given level of preretirement earnings, the program should replace a relatively constant percentage each year, regardless of fluctuations in the economy.

Now, we are not, by any means, advocating a freeze on the absolute dollar amounts of benefits, but we are saying that the percentage of replacement should stay constant and at a realistic level.

Under the present automatic-adjustment provisions, it is possible that after some years in the future the benefits provided by social security could equal or even exceed a participant's preretirement gross income and certainly his after-tax income. Such a situation would not only create financial havoc but would completely alter the original intent of the program.

While we see no problem with maintaining a cost of living escalator for retirees already on the rolls, we believe sincerely that the present method of computing initial retirement benefits must be overhauled in order to stabilize the future replacement ratio. The NAM believes that this can best be done by "wage-indexing" an employee's earnings record and then utilizing a new, dynamic benefit formula.

Also in the appendix to this statement there are three tables—labeled 3, 4, and 5—which illustrate the stabilizing effect of this approach. The examples are worked out for various types of steady earnings records.

We are concerned here with the "Primary Old Age Benefit as a Percent of Final Earnings" and the comparison between present law and the decoupled proposal in different years and under different sets of assumptions.

In tables 3, 4, and 5, the following three-tier benefit formula has been used: 100 percent of the first \$134 of average indexed monthly earnings (AIME) plus 29 percent of next \$766 of AIME, plus 20 percent of the excess AIME over the \$900.

It should be noted that the 3-dollar amounts in this formula would be increased by any future rise in wages.

Now, if you will look at table 3, this takes the employee retiring in 1976 and demonstrates that the proposed decoupled formula closely reproduces what present law would provide. It should be noted here that if the decoupled formula produces a lower benefit than under present law, a "savings clause" would operate to assure the worker of receiving the higher benefit.

In table 4, the situation becomes more interesting. We begin to see both the instability of the present law and the stability of the decoupled proposal. Looking down columns 3 and 4, we can see that under the decoupled proposal the percentage of earnings replaced remains constant under varying assumptions, while the percentage replaced under present law fluctuates considerably.

Table 5, dealing with a retirement in 2010, demonstrates even more vividly the stability of the decoupled proposal and the instability of the present law. In some instances, the benefit ratio under the present law rises close to or even above 100 percent, which was never intended.

Table 6 goes a step further. This table compares the benefit formula used in tables 3, 4, and 5 to a formula having 10 percent rather than 20 percent as its last incremental increase in benefits. This change has the effect of maintaining the benefit ratio at the maximum earnings level at about 31 percent of final earnings—which is the current percentage replaced. The use of 10 percent as the final increment would, therefore, seem to us to produce the most reasonable and equitable results.

What are cost effects of the NAM proposals? Earlier we looked at tables 1 and 2 which illustrated the life expectancy of the trust funds under two sets of assumptions. I think we can quickly demonstrate the soundness of NAM's proposals by referring you to one more table.

Table 7 incorporates our proposal for two modest increases in the tax rate and our proposal for decoupling the benefit formula. The increases in the tax rate will, as you can see, serve to keep each fund solvent through 1983. And, while only small cost savings can be attributed to decoupling in the near future, or short range, it is essential that this change also be implemented immediately so that long-range costs can be reasonably predicted and maintained within fiscally responsible limits.

In closing, the NAM strongly recommends that legislative attention be given in the very near future to both the necessity of modestly increasing the present tax rates and decoupling the present automatic increase formula in benefits for future retirees.

Gentlemen, this concludes the testimony on behalf of the NAM. If you would like to have us review any of the technical details with your committee staffs, we would be pleased to do so. On behalf of the NAM may I express our appreciation for the opportunity of being here and for your courteous attention.

Thank you.

[The prepared statement and appendix follows:]

STATEMENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS, PRESENTED
BY WALTER KLINT, CHAIRMAN, TASK FORCE ON SOCIAL SECURITY

SUMMARY

While there are many variables which must be considered in attempting to solve the Social Security financing problems, the NAM points to two fundamentals which should remain constant in all discussions of the program:

(a) The Social Security system must provide for equitable but responsible sharing of its costs between the productive employees and their employers, whose contributions serve to maintain the program.

(b) The intent of the system is to provide a floor of protection for retirees; it was *never* intended to fully replace pre-retirement income.

Despite what assumptions are used, it is clear that the Social Security program is rather quickly approaching insolvency. The NAM recommends that action to remedy this situation be taken immediately. It is felt that the longer the delay in taking remedial action, the more difficult it will become to do so.

The NAM proposes that the following two revisions are sufficient to handle the current financing problem during the next decade or even longer:

(a) A total 1% increase ($\frac{1}{2}\%$ employer- $\frac{1}{2}\%$ employee) in the tax rate should be legislated for 1976; a second such increase should be contemplated in 1980 or shortly thereafter.

(b) The present "automatic method" of calculating Social Security benefits should be decoupled. The NAM strongly supports the use of "wage-indexing" and a new, dynamic benefit formula for computing initial retirement benefits.

The NAM cannot support the following two proposals for fiscal reform:

(a) Arbitrary expansion of the taxable wage base.

(b) Any transfer of funds from general revenues.

STATEMENT

My name is Walter Klint and I am Director of Employee Benefit Programs for Continental Can Company in New York; I am also Chairman of the National Association of Manufacturers' Task Force on Social Security. With me today are Dr. Robert Myers, who serves as a consultant to the NAM; Randolph Hale, Assistant Vice President and Manager of the Industrial Relations Department of the NAM; and Brenda Ballard, Assistant Director of Employee Benefits for the NAM.

I welcome this opportunity to appear today on behalf of the National Association of Manufacturers, a voluntary, non-profit business organization with membership of over 13,000 organizations. As chairman of the NAM Social Security Task Force, I am here today to speak for American industry.

Having followed the many studies done recently on the Social Security program and having considered the various and varied proposals, we can appreciate the difficulty in arriving at a financing solution which will be welcomed by all. Because of the nature of the system there are many variables which must be considered. In view of the complexity of the problem, I'd like to preface my comments by emphasizing two underlying fundamental concepts which the Association believes should remain constant in any discussion of the Social Security program.

First, in seeking a solution to the financing problem, we must not lose sight of the fact that the system functions through a transfer of money from one generation to another. In other words, the system is based upon the ability of productive employees and their employers to finance the benefits of the present elderly, the disabled, and the survivors of deceased employees. Therefore, the cost to finance these benefits must be equitably and responsibly shared by our productive employees and their employers.

The second point I'd like to emphasize is that Social Security benefits should provide a floor of protection, not a full replacement of earnings. The balance of the economic security needs of our citizens should desirably come through the private sector, with a back-stop of public assistance for those whose needs are not met by Social Security plus other sources.

With these two fundamentals in mind, the NAM makes the following recommendations.

Immediate action is needed

In a recent editorial, *The Wall Street Journal* warned that the Social Security program may be heading toward the same financial disaster which now faces our City of New York, because no one in authority seems particularly worried. This comment seems to us to be unfair. Obviously, those in authority are concerned with the problems of Social Security. We must point out, however, that mere concern, without concurrent action, may serve to speed along the editorial's gloomy prophecy.

The 1975 Social Security OASDI Trustees' Report shows that, in this year, expenditures under the Old-Age, Survivors, and Disability Insurance Programs will exceed income by about \$3 billion. What's more, current estimates show that, under present law, outgo will exceed income in each future year. It is obvious that unless something is done to alter this course, the Social Security system will become insolvent—in fact, within about 5 years!

The important question to consider is this: how much time do we have before the OASI and DI Trust Funds are exhausted?

The first two tables in the Appendix to this statement, both of which have been prepared by Dr. Myers, illustrate the importance of expeditious action.

Table 1 shows the status of the OASI and DI Trust Funds over the next nine years, based on estimates presented in the 1975 Trustees' Report. The extension beyond 1979 has been estimated by Dr. Myers, using the same economic and other assumptions as those used by the Trustees. As you can see from this table, the OASI Trust Fund would be exhausted in late 1981, and the excess of outgo over income in 1983 would be as much as \$16 billion. The DI Trust Fund would be exhausted in early 1980, with the excess of outgo over income being as much as \$4 billion in 1983.

Now let's hypothesize that the projections in the 1975 Trustees' Report understate the financing problem, because the economic assumptions as to price and wage increases are overly optimistic. The Association concurs with Dr. Myers' belief that this is a reasonable hypothesis, since the Trustees assume that in 1976 to 1980 the annual rate of increase in wages will exceed the annual rate of increase in prices by about 3%—the reverse of the situation in recent years and substantially more than this differential has been in recent decades.

Table 2 of the Appendix presents the status of the OASI and DI Trust Funds over the next nine years, based on what we think are more realistic assumptions as to future price and wage changes. Specifically, the assumptions used for this table are those of the Trustees' Report (including the extension beyond 1980), but modified as follows:

- (1) no change in the assumed rate of increase in earnings, and
- (2) the rate of increase in the Consumer Price Index is 1% less than the rate of increase in earnings in 1976 and 2% less in the following years.

If this set of assumptions holds true, the OASI Trust Fund would be exhausted in 1980, and the excess of outgo over income in 1983 would be as much as \$26 billion. The DI Trust Fund would be exhausted in mid-1979, and the excess of outgo over income would be as much as \$5 billion in 1983.

By using more realistic assumptions, the life expectancy of the two trust funds becomes even shorter. It goes without saying that the longer we delay taking action to remedy the short-term deficit in the program, the greater the risk grows that the problem will become insolvable.

Increasing social security income

Studies on the Social Security system have resulted in a number of proposals for increasing the cash flow into the system. Before presenting NAM's position, I'd like to address myself to those recommendations which the Association *cannot* support, and briefly explain the reasons for our decisions.

It has been proposed that a much higher taxable earnings base than the present \$14,100 would be a desirable way to solve at least part of the financing problem. The NAM cannot support this proposal. The maximum taxable earnings base should *not* be used as a short range "convenience" financing mechanism; rather, it should only be kept up-to-date with changes in average covered wage levels, as is done now by the automatic-adjustment provisions. To those who have advocated a substantial and arbitrary increase in the taxable earnings base, we would point out that this approach would increase revenues far less than the equivalent of a $\frac{1}{2}\%$ increase in the rates of both the employee and the employer, on the present maximum wage base. What's more, such an increase would be inequitable because the additional tax burden placed on a higher paid employee would far outweigh the increase in his benefits.

The second proposal which the Association must oppose is a subsidy from general revenues—either directly or indirectly, such as a shift of medicare taxes which would be replaced by a government subsidy. Many people erroneously believe that money from general revenues comes from taxes that someone else paid. This, of course, simply isn't true. Consequently, the use of general revenues to finance Social Security is, at best, deceptive. It should also be pointed out that if participants are able to see their own tax rates with high visibility, they will be much more inclined to favor realistic limits to expansion of the program.

The NAM takes the position that the most responsible and equitable means of providing the needed flow of cash over the short-range would be two modest increases in the tax rate.

Although the 1975 Trustees' Report shows an estimated long-range deficit of 5.32% of taxable payroll, we do not believe that such a huge increase in the tax rate needs to be put up at the present time in order to assure the financial integrity of the program and the continuation of benefit payments over the next few years. We propose, therefore, that a total 1% increase in the tax rate— $\frac{1}{2}\%$ employer, $\frac{1}{2}\%$ employee—be legislated for no later than 1976. Another such increase will probably be necessary in 1980 or shortly thereafter. If, however, the optimistic assumptions of the 1975 Trustees' Report hold true, a second increase would not be required until possibly the mid-1980's.

As we mentioned earlier, one underlying fundamental which must remain constant in all discussions on the Social Security system is the fact that the cost to finance benefits must be shared equitably and responsibly between covered employees and their employers. Since the increases which we propose would be borne proportionately by all, we believe that this approach is the most equitable of available options.

In analyzing the problem of maintaining the system's fiscal solvency, we have been unable to separate the mechanism for feeding money into the system from the method of determining outgo. Therefore, we believe that our proposal of increases in the tax rate must be tied to a revamping of the method of computing initial Old-Age benefits awards.

Decoupling social security benefits

When the automatic-adjustment provisions governing the calculation of benefit amounts for new retirees were enacted in 1972, Congress was attempting to do automatically what had been done previously on an ad hoc basis, which had worked rather well. Essentially, their objective was to establish a means whereby benefit amounts both for new retirees and those already on the rolls would keep pace with increases in wages and prices.

It has now become apparent that the automatic-adjustment provisions will probably create great instability in the results of benefit computations and concomitant instability in the program's financing. If wages and prices rise at

approximately the same rate, and if that rate is relatively high, the benefits awarded each year in the future will represent higher and higher percentages of final earnings.

To clarify the situation, let me go back to our earlier statement in regard to the Social Security program providing a floor of protection. The Association believes that Social Security is not intended to fully replace a retiree's preretirement earnings. At a given level of pre-retirement earnings, the program should replace a relatively constant percentage each year, regardless of fluctuations in the economy. We are not, by any means, advocating a freeze on the absolute dollar amounts of benefits; but we are saying that the percentage of replacement should stay constant and at a realistic level.

Under the present automatic-adjustment provisions, it is possible that, after some years in the future, the benefits provided by Social Security could equal or even exceed a participant's pre-retirement income and certainly his after-tax income. Such a situation would not only create financial havoc but would completely alter the intent of the program.

While we see no problem with maintaining a cost of living escalator for retirees already on the rolls, we believe that the present method of computing initial retirement benefits must be overhauled in order to stabilize the replacement ratio. The NAM believes that this can best be done by "wage-indexing" an employee's earnings record and then utilizing a new, dynamic benefit formula.

Let us briefly explain how this "decoupling" works. We'll take a hypothetical employee who had earnings of \$6,000 in 1966. We'll assume that the average wage in covered employment was \$5,000 in 1966 and the average wage in covered employment in the year in which he retires is \$10,000. The worker's wage for 1966 is indexed in the following manner: \$6,000 is multiplied by \$10,000 over \$5,000, or 2 which produces an indexed wage for 1966 of \$12,000.

This employee had wages in 1966 in an amount below the maximum earnings base for that year, which was \$6,600. Therefore, the full amount of his earnings is indexed. Had his earnings been more than \$6,600 in 1966, only his earnings up to the maximum earnings base would be indexed.

A worker's wage for each year of covered employment is indexed in this manner. Then, in the same way that Average Monthly Wage (AMW) is now computed, the indexed wages are used to obtain the Average Indexed Monthly Earnings (AIME). The AIME is then applied to a new and updated benefit formula.

In the Appendix to this statement there are three tables (labeled 3, 4, and 5), which have been prepared by Dr. Myers to illustrate the stabilizing effect of this approach. The examples are worked out for various types of steady earnings records: maximum taxable earnings in all years, average earnings in all years, and various percentages of average earnings. Three cases of retirement at age 65 are shown: one at the beginning of 1976, another at the beginning of 1994, and a third at the beginning of 2010.

We are concerned here with the "Primary Old Age Benefit As A Percent of Final Earnings" and the comparison between present law and the decoupled proposal, in different years and under different sets of assumptions.

In Tables 3, 4, and 5, Dr. Myers has used the following three-tier formula: 100% of the first \$134 of AIME; plus 29% of the next \$766 of AIME; plus 20% of the excess AIME over \$900.

It should be noted that the three dollar amounts in this formula would be increased by the rise of wages in the future for retirees in the coming years.

Table 3 considers workers retiring in 1976 and demonstrates that the proposed decoupled formula closely reproduces what present law would provide. It should be noted here that if the decoupled formula produces a lower benefit than under present law, a "savings clause" would operate to assure the worker of receiving the higher benefit.

In Table 4, we begin to see both the instability of the present law and the stability of the decoupled proposal. Looking down columns 3 and 4, we can see that, under the decoupled proposal, the percentage of earnings replaced remains constant under varying assumptions, while the percentage replaced under present law fluctuates considerably. Although Table 4 varies only the Consumer Price Index increase assumptions, the results would be of the same nature for assumptions in earnings increase other than the 5% used.

Table 5, dealing with a retirement in 2010, demonstrates even more vividly the stability of the decoupled proposal and the instability of the present law. In some instances, the benefit ratio under the present procedures rises close to or even above 100%, which was never intended.

Table 6 goes a step further. This table compares the benefit formula used in Tables 3, 4, and 5 to a formula having 10% as its last incremental increase in benefits. This change has the effect of maintaining the benefit ratio at the maximum earnings level very close to 31% of final earnings—the current percentage replaced. The use of 10% as the final increment would, therefore, produce the most reasonable and equitable results.

Cost effect of NAM proposals

Earlier we looked at two tables (labeled 1 and 2) which illustrated the life expectancy of the trust funds under two sets of assumptions.

I think we can quickly demonstrate the soundness of the NAM's proposals by referring you to one more table.

Table 7, prepared by Dr. Myers, incorporates our proposal for two small increases in the tax rate and our proposal for decoupling the benefit formula. The increases in the tax rate will, as you can see, serve to keep each fund solvent through 1983. And, while only small cost savings can be attributed to decoupling in the near future it is essential that this change also be implemented immediately so that long-range costs can be reasonably predicted and maintained within fiscally responsible limits.

In conclusion, the NAM strongly recommends that legislative attention be given in the very near future to both the necessity of modestly increasing the present tax rates and decoupling the present automatic increase formula in Old-Age Benefits for future retirees.

APPENDIX

TABLE 1.—ESTIMATED STATUS OF OASDI TRUST FUNDS AS PER 1975 TRUSTEES' REPORT

[In billions of dollars]

Calendar year	Total income	Total outgo	Net income	Fund at end of year	Calendar year	Total income	Total outgo	Net income	Fund at end of year
Old age trust fund:					Disability trust fund:				
1975----	58.6	60.8	-2.2	35.6	1975----	7.9	8.7	-0.8	7.3
1976----	63.8	68.1	-4.3	31.3	1976----	8.6	10.1	-1.5	5.8
1977----	72.2	76.2	-4.0	27.3	1977----	9.6	11.3	-1.7	4.1
1978----	80.1	84.4	-4.3	23.0	1978----	11.0	12.7	-1.7	2.4
1979----	88.2	93.0	-4.8	18.2	1979----	12.1	14.1	-2.0	.4
1980----	94.0	101.6	-7.6	10.6	1980----	13.0	15.4	-2.4	-----
1981----	100.0	110.7	-10.7	-----	1981----	13.9	16.8	-2.9	-----
1982----	106.8	120.4	-13.6	-----	1982----	14.9	18.3	-3.4	-----
1983----	114.4	130.8	-16.4	-----	1983----	16.0	19.9	-3.9	-----

TABLE 2.—ESTIMATED STATUS OF OASDI TRUST FUNDS USING REVISED ASSUMPTIONS

[In billions of dollars]

Calendar year	Total income	Total outgo	Net income	Fund at end of year	Calendar year	Total income	Total outgo	Net income	Fund at end of year
Old age trust fund:					Disability trust fund:				
1975----	58.6	60.8	-2.2	35.6	1975----	7.9	8.7	-0.8	7.3
1976----	63.6	68.6	-5.0	30.6	1976----	8.6	10.2	-1.6	5.7
1977----	71.9	78.2	-6.3	24.3	1977----	9.6	11.6	-2.0	3.7
1978----	79.7	88.2	-8.5	15.8	1978----	11.0	13.3	-2.3	1.4
1979----	87.5	98.2	-10.7	5.1	1979----	12.1	14.9	-2.8	-----
1980----	93.2	108.4	-15.2	-----	1980----	13.0	16.4	-3.4	-----
1981----	99.7	118.9	-19.2	-----	1981----	13.9	18.0	-4.1	-----
1982----	106.8	129.2	-22.4	-----	1982----	14.9	19.6	-4.7	-----
1983----	114.4	140.3	-25.9	-----	1983----	16.0	21.4	-5.4	-----

Note: The revised assumptions used for the estimates in this table are those of the trustees' report (plus the extension as described earlier) modified as follows: (1) no change in the assumed rates of increase of earnings, and (2) the rate of increase in the CPI is 1 percent less than the rate of increase in earnings in 1976 and 2 percent less in subsequent years.

TABLE 3.—COMPARISON OF BENEFITS UNDER PRESENT LAW VERSUS A DECOUPLED FORMULA

[Male attaining age 65 at beginning of 1976]

Earnings record	Primary old age benefit ¹		Benefit as percent of final earnings		Present benefit as percent of decoupled benefit
	Present law	Decoupled proposal	Present law	Decoupled proposal	
Maximum.....	\$364.00	\$363.60	31	31	100.1
125 percent of average.....	343.90	353.00	39	40	97.4
Average.....	304.70	307.20	42	42	99.2
75 percent of average.....	253.30	254.10	46	46	99.7
50 percent of average.....	198.60	201.00	54	55	98.8
25 percent of average.....	145.60	148.00	80	81	98.4

¹ Description of proposed formula for primary old age benefit: 100 percent of 1st \$134 of AIME, plus 29 percent of next \$766 of AIME, plus 20 percent of excess of AIME over \$900. AIME is the average indexed monthly earnings, computed as the average monthly wage now is, except that the earnings record is indexed on the basis of the average wages in covered employment in the various years.

Note: When decoupling produces a lower figure than present law, a savings clause would apply, and the larger amount would be payable.

TABLE 4.—COMPARISON OF BENEFITS UNDER PRESENT LAW VERSUS A DECOUPLED FORMULA

[Male attaining age 65 at beginning of 1994]

Earnings record	Primary old age benefit		Benefit as percent of final earnings		Present benefit as percent of decoupled benefit
	Present law	Decoupled proposal	Present law	Decoupled proposal	
5 percent earnings increases; 4 percent CPI increases:					
Maximum.....	\$1,256	\$1,046	44	36	120
125 percent of average.....	1,144	958	47	39	119
Average.....	1,035	824	53	42	126
75 percent of average.....	906	681	62	46	133
50 percent of average.....	677	539	69	55	126
25 percent of average.....	441	397	90	81	111
5 percent earnings increases; 3 percent CPI increases:					
Maximum.....	1,110	1,046	39	36	106
125 percent of average.....	1,012	958	42	39	106
Average.....	916	824	47	42	111
75 percent of average.....	801	681	54	46	118
50 percent of average.....	598	539	61	55	111
25 percent of average.....	389	397	79	81	98
5 percent earnings increases; 2 percent CPI increases:					
Maximum.....	987	1,046	34	36	94
125 percent of average.....	899	958	37	39	94
Average.....	814	824	42	42	99
75 percent of average.....	712	681	48	46	105
50 percent of average.....	532	539	54	55	99
25 percent of average.....	346	397	71	81	87

Note: Earnings and CPI increase assumptions for 1975-80 are graded in from current levels to the ultimate assumptions shown above.

TABLE 5.—COMPARISON OF BENEFITS UNDER PRESENT LAW VERSUS A DECOUPLED FORMULA

[Male attaining age 65 at beginning of 2010]

Earnings record	Primary old age benefit		Benefit as percent of final earnings		Present benefit as percent of decoupled benefit
	Present law	Decoupled proposal	Present law	Decoupled proposal	
5-percent earnings increases; 4-percent CPI increases:					
Maximum.....	\$3,303	\$2,420	48	35	136
125 percent of average.....	3,006	2,101	56	39	143
Average.....	2,763	1,798	65	42	154
75 percent of average.....	2,463	1,488	77	46	166
50 percent of average.....	2,068	1,177	97	55	176
25 percent of average.....	1,392	867	130	81	161
5-percent earnings increases; 3-percent CPI increases:					
Maximum.....	2,539	2,420	37	35	105
125 percent of average.....	2,295	2,101	43	39	109
Average.....	2,096	1,798	49	42	117
75 percent of average.....	1,865	1,488	58	46	125
50 percent of average.....	1,497	1,177	70	55	127
25 percent of average.....	1,054	867	99	81	122
5-percent earnings increases; 2-percent CPI increases:					
Maximum.....	1,962	2,420	28	35	81
125 percent of average.....	1,754	2,101	33	39	83
Average.....	1,594	1,798	37	42	89
75 percent of average.....	1,419	1,488	44	46	95
50 percent of average.....	1,192	1,177	56	55	101
25 percent of average.....	802	867	75	81	93

Note: Earnings and CPI increase assumptions for 1975-80 are graded in from current levels to the ultimate assumptions shown above.

TABLE 6.—COMPARISON OF 2 BENEFIT FORMULAS WITH DIFFERENT WEIGHTING FOR HIGHEST EARNINGS

[Assumes maximum covered earnings for male age 65]

Date of attaining age 65	Primary old age benefit ¹		Benefit as percent of final earnings	
	Formula A	Formula B	Formula A	Formula B
January 1976.....	\$364	\$362	31	31
January 1994.....	1,046	1,000	36	34
January 2010.....	2,420	2,252	35	32

¹ Description of formulas for primary old age benefits: Formula A—see description in table 3; formula B—same as formula A except that last factor is 10 percent instead of 20 percent.

Note: Earnings increase assumptions for 1975-80 are graded in from current levels to the ultimate assumption of 5 percent per year.

TABLE 7.—ESTIMATED STATUS OF OASDI TRUST FUNDS AFTER PROPOSED REVISIONS TO PROGRAM

[In billions of dollars]

Calendar year	Total income	Total outgo	Net income	Fund at end of year	Calendar year	Total income	Total outgo	Net income	Fund at end of year
Old age trust fund:					Disability trust fund:				
1975.....	58.6	60.8	-2.2	35.6	1975.....	7.9	8.7	-0.8	7.3
1976.....	69.6	68.7	+9	36.5	1976.....	9.8	10.2	-4	6.9
1977.....	79.1	78.4	+7	37.2	1977.....	11.1	11.6	-5	6.4
1978.....	88.1	88.5	-4	36.8	1978.....	12.8	13.4	-6	5.8
1979.....	97.4	98.4	-1.0	35.8	1979.....	14.3	14.9	-6	5.2
1980.....	112.9	108.4	+4.5	40.3	1980.....	17.4	16.4	+1.0	6.2
1981.....	121.2	117.7	+3.5	43.8	1981.....	18.6	17.8	+8	7.0
1982.....	130.1	125.3	+4.8	48.6	1982.....	19.8	19.0	+8	7.8
1983.....	139.6	133.3	+6.3	54.9	1983.....	21.4	20.3	+1.1	8.9

Note: The assumptions used for the estimates in this table are the same as described in the note of table 2.

Mr. BURKE. Thank you very much.

Mr. JONES.

Mr. JONES. Thank you, Mr. Chairman.

Can you tell me, under your proposal, the total 1-percent increase in tax base, how much more would that add to the trust fund, say, over the next 4 or 5 years in comparison to raising the earnings base to \$24,000?

Mr. KLINT. I think we can give you a reasonable approximation of that, and as that is an actuarial question, I will refer it to our actuary.

Mr. MYERS. Mr. Chairman, raising the tax rate by 1 percent on the employer and the employee combined, would bring in about \$6 billion a year initially, and then as wages go up in the future, somewhat more, possibly in the next few years, that figure would reach \$7 billion a year.

Mr. JONES. All right.

Mr. MYERS. If you raise the maximum taxable earnings base to—did you give any figure?

Mr. JONES. I said \$24,000.

Mr. MYERS. \$24,000, thank you.

If you raise the maximum earnings base to \$24,000 effective next year, let's say—

Mr. JONES. For the same time period that you are figuring?

Mr. MYERS. This would increase revenues initially by somewhat more than \$6 billion. I would say somewhere around \$8 billion a year. But then over the years there would be additional benefit outgo that would eat into that additional gross income, so that the net effect would not be nearly as much as it would be in the first year of operation.

[Mr. Myers later submitted for the record the information that the increase in tax income for 1976 by raising the base to \$24,000 would be \$7.3 billion, while the increased income by raising the combined employer-employee tax rate by 1 percent would be \$6.8 billion.]

Mr. JONES. Then that would refute my assumption that the 0.5-percent increase in tax on the employer would be more expensive to the employer than the additional tax from the \$14,000 to \$24,000 level?

Mr. MYERS. Yes; I am quite certain—

Mr. JONES. Really?

Mr. MYERS [continuing]. That it would be a bit more expensive for the employer, if the maximum taxable earnings base went to \$24,000.

Mr. JONES. As you raise your earnings base?

Mr. MYERS. Yes.

Mr. KLINT. As you rapidly diminish your earnings base, most of the gain, not nearly as much in going from \$20,000 to \$22,000 as in going from \$14,000 to \$15,000 or \$16,000, correct?

Mr. MYERS. Yes.

Mr. JONES. The thing that bothers me is that the additional tax on the employee is a tremendous burden, and on the small businessman, for that matter.

Mr. KLINT. Well, gentlemen, we are not running a philanthropic or charity program.

Mr. JONES. I understand that.

Mr. KLINT. We have been running a program we have to keep fiscally sound which probably was playing too fast and loose already. You only get what you pay for.

Mr. JONES. I understand that.

Mr. KLINT. And we have got to be big enough to face up to that. Lord knows if we bring in general revenues—the sky is the limit.

Mr. JONES. I don't support use of general revenues.

Mr. KLINT. I mean we have got a real gutsy problem in front of us. We have got to have the backbone to face up to it foursquare. It is not going to go away if you try to sweep it under the rug.

Mr. JONES. I understand that. It is a question of which approach we take.

Mr. KLINT. Now something has got to be done.

Mr. BURKE. Well, Mr. Klint, I want to thank you for appearing here. You are the first witness who came out and spoke of raising taxes in 1976.

Mr. KLINT. Do I get that paragraph in your memoirs?

Mr. BURKE. You are going to be mentioned.

Mr. KLINT. Thank you very much, gentlemen.

Mr. BURKE. I agree with you on that part, where you say we can't put this thing off and that revenue should be raised. I wish there were more of my colleagues here to hear your testimony because I think they might have been persuaded to act a little bit more quickly.

Mr. KLINT. Let me just repeat, Mr. Chairman, that what you have heard today is not my own personal opinion, as probably the opinions of many of the other people testifying were. This represents an opinion of 10,000 employers. We are the biggest single source of revenue for the whole system.

Mr. BURKE. I want to thank you for bringing Mr. Myers along, because he is one of the most able actuaries in the world.

Mr. KLINT. The ablest in this field, in our opinion.

Mr. BURKE. Thank you very much.

We are going to have a little recess while we vote and then we will hear Mr. Cruikshank.

[A recess was taken.]

Mr. BURKE. We welcome Mr. Nelson Cruikshank, the president of the National Council of Senior Citizens. He has appeared before this committee many times before and his expertise on this subject is recognized by all. So we are happy to have him here today.

You may proceed with your testimony.

STATEMENT OF NELSON CRUIKSHANK, PRESIDENT, NATIONAL COUNCIL OF SENIOR CITIZENS, ACCOMPANIED BY RUDOLPH DANSTEDT, ASSISTANT TO THE PRESIDENT

Mr. CRUIKSHANK. Thank you, Mr. Chairman, Mr. Cotter.

I am very happy to have the opportunity to appear on this very important subject. With your permission, I would like to ask Mr. Rudolph Danstedt to join me. Mr. Danstedt is the assistant to the president of the National Council of Senior Citizens and was a member of the National Senior Citizens Advisory Council on Social Security, as I am sure you are aware, because he has appeared in that capacity here with you.

Mr. BURKE. Yes, sir.

Mr. CRUIKSHANK. Mr. Chairman, I have submitted my statement in advance, and I would like to ask permission that it be included in the record. But in the interest of time and possibly with a view to

adding a couple of comments which won't be too long, I would summarize the statement.

Mr. BURKE. Without objection your entire statement will appear in the record at this point.

Mr. CRUIKSHANK. Thank you, sir.

[The statement referred to follows:]

STATEMENT OF NELSON H. CRUIKSHANK, PRESIDENT, NATIONAL COUNCIL OF SENIOR CITIZENS

Mr. Chairman, Members of the Subcommittee on Social Security, my name is Nelson H. Cruikshank. I am President of the National Council of Senior Citizens.

The National Council is a non-profit, non-partisan organization of more than 3,000 older people's clubs in all states.

I deeply appreciate this opportunity to present the views of the National Council on the financing of Social Security, with particular emphasis on the need to strengthen the short-range financing of the program.

Appropriately, the Subcommittee has chosen to take action on legislation affecting early-year financing (the next 25 years), before considering legislation affecting long-range financing (the next 75 years). These are, in our view, properly separable, involving hard fact and early action for the short-run aspects of the problem and highly speculative assumptions far into the future for the long-range aspects.

Whether the financing problems are short-run or long-run, however, I urge that they be viewed in proper perspective. *The cause of the problems is not the Social Security system.* Economic and demographic factors are the cause.

This would appear to be obvious on a moment's reflection. But strangely enough, some of the present day critics of Social Security seem to be writing from the premise that *because* we have Social Security, come the year 2035 there are going to be only 30 people over age 65 for every 100 of working age, as contrasted to 18.3 in that group at present.

It is by no means certain that these figures will accurately reflect the population make-up 60 years from now; if experience does bear them out, however, it will be a problem for society as a whole. But it will not confront us because of Social Security. Social Security is the answer to the problem—not the problem itself. It is of course less than a perfect answer. And it will have to be adjusted and improved and it will have to find additional financial resources to meet such demographic changes if they do indeed occur. But the same problem will, in this event, confront every device that has been developed or may be developed in the future to meet the problem of income maintenance in old age. It will be a problem for private pension plans—a problem for private annuity programs, and for individual savings and investment programs, as well as for Social Security. It will be a problem for all these, assuming of course that America will never accept the unthinkable alternative of letting its older people starve or prematurely die of unattended disease.

Demographic factors are responsible for the long-range financing problems. By no stretch of the imagination can we hold the Social Security system responsible for current birth rates. People are living longer. But if the cash benefits keep our aged from starving to death, and Medicare benefits help to prevent untimely death, no one would wish it otherwise.

For the short-run financing problems, on the other hand, the deplorable state of our economy in recent years is largely responsible.

Unemployment, at the same time that it cuts down payroll-tax income, increases out-go as more and more older workers lose their jobs and are forced on to the retirement rolls. But is the Social Security system the *cause* of the unemployment problem? Obviously not. Instead, it is part of the remedy in that it provides a source of income for those older workers who can no longer continue in gainful employment.

Inflation, too, greatly increases Social Security outlays now that benefits are adjusted to increases in the cost of living. But the Social Security system is not the *cause* of inflation. Again, it is one means of ameliorating an intolerable situation.

The economy of recent months—combining double-digit inflation with close to double-digit unemployment—has resulted in more money being paid out in Social Security benefits than is currently being paid in by workers and their employers. I emphasize again that Social Security is not the *cause* of this problem. But it can be part of the solution because it is good for the economy to have this money poured

back in through purchases of consumer goods. And we can be sure that practically all Social Security benefit checks are immediately spent on essentials of daily living instead of being deposited in savings accounts.

I will not focus on our recommendation for dealing with the short-run financing problems of the Social Security system, and ask that we have an opportunity to participate when the Subcommittee turns its attention to long-range aspects.

This Subcommittee is fully aware that the Social Security system is currently spending more than it is taking in. The National Council believes that some reduction in the trust funds in the next few years is not to be deplored. The trust funds are intended to serve during periods of recession. The fact that Social Security beneficiaries get more money to spend than is currently being deducted from payrolls in Social Security taxes is good for a depressed economy.

However, the 1975 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds has thrown new light on the magnitude and urgency of the problem. In summary, this report says: "The estimates indicate that, without legislation to provide additional financing, the assets of both trust funds will be exhausted soon after 1979."

This situation demands early action.

I turn then to our recommendations for such legislation.

First, the National Council supports the recommendation of the Social Security Advisory Council for what is commonly called "decoupling". Decoupling addresses itself to a defect in the automatic provisions of present law. Under existing provisions when a future benefit is computed, it is a combination of the increase in the Social Security benefit for a *particular average wage level*—an increase which alone fully reflects the higher cost of living—*plus the increase in the average itself*, which results in an updating of the level of protection for those still contributing to the program. This combination is, of course, considerably more than enough to keep up with prices; it could result in a scale of benefits that over the long run exceeds pre-retirement wages.

The decoupling proposal of the Advisory Council would, as you know, guarantee that protection for current workers be kept up automatically at least as high as future increases in the level of earnings and that, as at present, benefits once payable would be kept up to date with increases in the cost of living. We consider this to be an improvement over the happenstance of the present provision in that it would assure workers that when they retire, they can count on a wage-replacement fixed in advance and thereafter adjusted to price rises. And, unlike most improvements, decoupling would save money, substantially reducing the actuarial imbalance of the system.

Second, the employer's full payroll should be taxed and the wage base for workers should be increased to \$24,000 beginning in calendar year 1977.

A maximum on the benefit and contribution base for individual workers is appropriate since the amount that people pay and the amount that is credited to their record for benefit purposes should be tied together, and it would seem unreasonable under social insurance to compute benefits on the very high salaries earned by the top 2% or 3% of the wage-earning portion of the population. There is no similar need for a limitation on employer's payroll. The tax on employer's payroll is less now than contemplated in the original Social Security Act. There was then provided an ultimate combined employer tax rate for Social Security and unemployment compensation totalling 6%. Because of the lower proportion of wages now covered under the experience rating of unemployment compensation and the increased tax deductible advantages now available through corporate tax laws, the tax burden on employers is now significantly less than provided by the original law.

Under the present law, the wage base—the maximum amount counted for contributions and the computation of benefits—can be expected to be approximately \$16,800 in 1977. In proposing that it be increased to \$24,000 for calendar year 1977, we would point out that the economic impact would not be felt until the fall of 1977—when all indications point to economic recovery—because no significant number of workers would receive earnings exceeding \$16,800 earlier in the year.

The increase in the wage base we are proposing would return the system, partly, but not all the way, to the original program intent. In 1938, the first year which there are adequate Social Security data (the Social Security system began to collect contributions in 1937), 97% of all the workers in the system had their full wages counted toward Social Security. Today, only 85% of the workers covered by the system have all of their earnings counted. To get back to the situation that existed at the time the program first went into effect would require an

earnings base substantially in excess of what we propose, probably an earnings base in 1977 of about \$30,000.

Moreover, raising the wage base to \$24,000 obviates the necessity for an increase in the contribution rate—a position which we strongly favor—and imposes no additional cost on the middle level and lower paid workers, while providing increased protection for those who pay more. It is important to emphasize that the Social Security program provides a unique protection which offers the workers absolute assurance as to vesting, portability and receipt of benefits when they are due. Raising the maximum earnings base increases benefit protection for workers as well as contributes to the improved financing of the program. For example, if the maximum earnings base were increased to \$24,000, a 55 year old worker earning the maximum amount would get nearly \$125 a month more when he retired at 65 than he would if the earnings base were left as in present law. If he were 60 when the increased earnings base went into effect, he would get benefits at 65 of somewhat more than \$50 a month above present law.

Our third proposal is that the increase in Medicare contributions of 0.2 percent each on employers and employees, scheduled for 1978, be allocated to the cash benefits program. With a higher benefit and contribution base, the contribution schedule in present law would substantially over-finance the Medicare hospital insurance program for many years into the future. Consequently, it would be possible to allocate the 1978 scheduled increase of 0.2% of payroll on employees, and a like amount on employers, to the cash benefit program rather than to the hospital program. We propose that this be done.

In this connection, I would like to emphasize our strong opposition to the recommendation of the Social Security Advisory Council that the hospitalization insurance part of Medicare be changed from a program of contributory social insurance to one which would be entirely supported by general revenues and that all contributions now earmarked for hospital insurance be shifted to the support of the cash benefit program. Fortunately, the Congress appears to be alert to the fact that such a change would inevitably lead to making Medicare a welfare program, destroying the basic character of the program for which we fought so long and hard. (I think most of you know that the National Council of Senior Citizens was originally formed for the express purpose of achieving Medicare and that our first President was the Honorable Aimé J. Forand, esteemed former member of the House Ways and Means Committee.)

There are some who choose to find it inconsistent that the National Council, which strongly favors tripartite financing of Social Security, should oppose the Advisory Council's recommendations for financing hospital insurance out of general revenues. In our judgment there is no inconsistency in this position. Tripartite financing preserves the contributory nature of the program and the principle of benefits as an earned right at the same time that it makes the financing of the system more progressive. The government's share is a recognition that society as a whole benefits from our contributory social insurance program. Welfare costs over the years have been substantially lower because the Social Security system picked up the accrued costs—the equivalent of past service credits—when the system began and when its coverage was extended. This is a cost properly chargeable to general revenues, not to the contributions paid by current workers. To finance a program solely out of general revenues, on the other hand, would almost certainly lead to the loss of the concept of earned right and to the introduction of an income or means test into the program. This we must not do.

In the long-run, we see a Social Security system covering both cash benefits and health insurance, financed partly by employer contributions, partly by employee contributions, and partly by contributions from the government in recognition of society's stake in a well-functioning social insurance program. This too is the type of fully developed Social Security system envisioned by the experts who designed our first steps toward Social Security four decades ago. Tripartite financing has long been used successfully in all the major foreign social insurance systems.

The steps that we have proposed—decoupling, the increase in the maximum earnings base, the tax on the employer's total payroll and the reallocation of the 1978 contribution increase from hospital insurance to the cash benefit program—can be expected to solve the immediate short-run financing problem of the cash benefit program. Depending on what happens to wage and cost of living rates, these changes might be all that is required into the next century. But, under other circumstances a limited contribution may be required from the general revenues as early as the last decade of this century.

Regardless of the date, in order to reinforce public confidence in the system, we propose to meet this possible contingency by restoring to the Social Security law the provision for general revenue financing that existed from 1944-1950 as follows:

"There is also authorized to be appropriated to the Trust Fund such additional sums as may be required to finance the benefits and payments provided for in this Title."

As our final recommendation for a change in existing legislation, the National Council urges the members of this Subcommittee to support legislation that would establish the Social Security Administration as an independent agency, prohibit the mailing of partisan political notices with Social Security and Supplemental Security Income checks, and separate the transactions of the Social Security Trust Funds from the Unified Budget. Such a legislative proposal has been introduced in the Senate by Senator Frank Church (S. 388) with three dozen co-sponsors, and in the House by Congressmen Helstoski, Roe and Hanley (H.R. 3108).

That this important legislative proposal is germane to your consideration of the financing of Social Security can be illustrated by the President's budget proposal to limit the statutory cost-of-living increases in Social Security benefits to an arbitrary 5 percent.

What the President's plan would have done—had not the Congress in its wisdom whole-heartedly rejected it—would have been to allow the Administration to use the improved financial position of the Social Security Trust Funds, resulting from the cut back in benefits, to offset part of the deficit in the overall budget, thus making the general budget appear better than it is in fact. This is not only bad social policy—increasing the hardship of older people and the widows, orphans and disabled to reduce budget deficits—but it is dishonest accounting practice. If the head of a business corporation would use the same device in reporting corporation assets to his stockholders, he would be subject under the new Pension Reform Act, to all the penalties of the law.

The clear evidence of impracticality and political chicanery in the Ford budget-cut proposals calls for early action by the U.S. Congress to protect the Social Security Trust Funds from White House manipulation.

I appreciate that this Subcommittee's hearings are directed at legislation needed to improve the financing of Social Security, rather than its benefits. Appropriate to your considerations, however, is the retirement test in view of its cost impact. We urge you to resist all pressures to eliminate or unduly liberalize this test.

The National Council has consistently opposed the elimination of the retirement test under Social Security. During this period of stagflation, we have redoubled our opposition on economic grounds. Elimination of the retirement test is essentially a proposal to add a bonus to the earned income of the small proportion of the elderly who are physically able to continue in their jobs and for whom jobs are available—many of them, lawyers, doctors and high paid professionals. It is unconscionable to add to the system the burden of such a bonus, amounting to roughly \$5 billion annually, to be borne out of payroll taxes at a time when workers' real wages are declining. Some have countered that the extra cost could be borne out of general revenues. As I have said, we firmly believe that general revenue financing should be introduced—but it should be used to support improved benefits for the 90 percent of the elderly who are too old or too ill to work and for whom there is not the remotest possibility of employment, especially in this depressed labor market.

I realize that there is considerable pressure to eliminate the retirement test. This, I submit, for the most part comes from a misunderstanding of the nature of the Social Security system and its purpose. And I must admit I don't quite understand the criticisms of the system based on its requirement of substantial retirement from the labor market as a condition of eligibility for retirement benefits while no like criticism is made against private pension plans for having essentially the same—and usually far stricter—tests of retirement. No private pension plan that I know of permits a person to remain on the company payroll and still draw his pension. I submit it is incumbent on those of us who do understand this system to help explain it to the public. When there is more widespread understanding there will be a greater readiness to defend it against unwarranted allocation of trust fund resources.

In conclusion, thank you, personally and on behalf of the National Council of Senior Citizens, for this opportunity to present our views on the short-range financing aspects of the Social Security program.

Mr. BURKE. You may proceed.

Mr. CRUIKSHANK. It was interesting to me that Mr. Klint from the NAM, who preceded me here, made reference to an editorial in the Wall Street Journal, and I happen to have that same editorial with me as I wanted to comment on it.

It was an editorial of the issue of June 3, in which they made what I think he correctly referred to as an unfair comparison, pointing out the financial difficulties of the city of New York, and comparing them with the problems of social security, and saying that they came from a like cause of irresponsibility.

I would join Mr. Klint, not in all of the things he submitted, but certainly in this, that that is an unfair and unrealistic statement in the editorial of the Wall Street Journal. Their theme is that nobody is paying any attention to the problems of social security. Well, the very fact that you are holding these hearings, Mr. Chairman, shows that that is not true. You are paying attention to it.

Then they make the comparison saying that the city of New York acted for years irresponsibly, just giving away money without worrying about when they were going to pay for it. That is not a comparison, because this committee, the Ways and Means Committee, has over the years in which I have been privileged to appear before it, beginning back in the early 1940's, taken very responsible positions. They have been concerned with the financing. They have not irresponsibly added benefit to benefit without being concerned about the financing.

This meeting in this series of hearings you are holding is consistent with the tradition of the responsible position of this committee, the responsible attitude of this committee and of the Congress rests as a whole, with respect to social security.

Now, this is just one more evidence of what I think is a rather shameless series of attacks by the press. Some of it we can understand, but a more responsible paper like the Wall Street Journal should know better than joining in these attacks on the system and attacks on the Congress, which in effect become attacks on the people and their state of mind.

The people whom I am now representing, the people of the National Council of Senior Citizens, many of them older, many of them not schooled in the intricacies of these things, when they read these things in the paper their fears are built up and their sense of insecurity is exaggerated because of these statements.

And I take a minute just to refute that kind of statement in a newspaper which should know better than to make those kinds of attacks.

Now, many of these concerns have gone beyond the necessity of the real situation. There is a problem of financing social security. There are problems about our social security system. But some of the writers and some of the commentators deal with this as if this were a problem caused by the social security system itself. It is a rather peculiar twist of mind, it seems to me. They point out, for example, the increase in the numbers of people of nonworking age, that is, of retirement age, in relation to the proportion of people of working age, and the inference is that this results because we have got a social security system.

Well, this of course isn't true at all, as a moment of thought will clear up. These are demographic changes, and the social security system is an answer to that problem, not the cause of the problem.

Now, in some respects it is an inadequate answer; and among your purposes in meeting here is how to make it a more adequate answer.

But if there are going to be more people of retirement age than there are in the work force, that certainly didn't result because we have a social security system. But to read some of these editorials and magazine articles you would think that was the case.

Some of the shortrun problems which our present sessions are addressing themselves to arise by causes completely out of the social security system, that is, this portion of the social security system that we are considering now. They arise out of unemployment, they arise because of certain fiscal and monetary problems that have been in effect in our economy.

Again, the social security system is an answer to those problems, a partial answer, at least, and certainly not the cause of it. We can't blame unemployment and the fact that now about 70 percent of the men retiring are retiring with a reduced benefit before age 65. We can't blame that on the fact that there is a system and there is the possibility of this kind of early retirement.

We blame it, properly, I think, in the shrinkage in work opportunities in the labor market today.

Incidentally, I admit that there is considerable concealed unemployment in this early retirement. Those people that are retiring at drastically and actuarially reduced benefits at age 62. Many of them we know are not doing it by choice, they are doing it because there is a shrinkage in the employment opportunities. But they are immediately counted out of the labor market, and thence are not figured in the base on which the percentage of unemployment is figured. They are figured as being retired and out of the labor market.

If you could, if it were possible to ascertain the motives of retirement in all of these cases, I think we would find that those who would go to work if there were work opportunities available would increase the number in the labor force and the percentage of unemployment would go up substantially, if those people were included.

Inflation is one of the problems of our present system, but certainly the problem of inflation is not a cause of the problems of social security.

Now, all of these things being said, does not mean that we don't have a problem. We do have some shortrun problems and we have some longrun problems. You and the members of the committee are fully aware that the system is currently spending more than it is taking in. The national council believes that some reduction in the trust fund in the next few years is not to be deplored, it doesn't spell catastrophe. They are intended to serve this purpose in the period of recession.

As a matter of fact, I was interested in reading in the statement of Stebank of New York in which they are making their predictions, it was interesting to note in their statement they said we couldn't have a serious kind of 1929-to-1933 depression in this country, because of the existence of such cushions as unemployment insurance and old age and survivors insurance; that these served an economic function, they served a purpose for the economy as a whole, as well as a purpose to relieve the stress of the individual beneficiaries.

The 1975 annual report of the board of trustees on the Federal old age and survivors insurance disability trust funds has thrown new light on the magnitude and urgency of the problem. They have stated the estimates indicate that without legislation to provide additional financing the assets of both trust funds will be exhausted soon after 1975. So this situation demands early action.

Now, those assumptions of course include some of the most drastic and rather readily correctable factors. It is fair to include them in the assumptions, but it isn't fair, I think, to draw the conclusion as has been drawn, which the trustees incidentally do not, they do not say that they are facing a great catastrophe, or that we are up against a situation where everything is going to go broke. They quite properly take into account the assumptions and the conditions of the existing law, and say if they are not changed then we will be in real trouble.

Now, of course we can change some of those, and these are the proposals that we would suggest.

The first correction that we would suggest, and I believe it has been suggested by a number of other witnesses, is that we support the recommendation of the Social Security Advisory Council for what is commonly called decoupling. That has been dealt with at length here, and it means that under certain conditions, a certain set of conditions, the benefit structure could really run away with the whole system, and we would be in real trouble.

Now, in the cost of living proposals, the cost of living provisions that were added to the law by the Congress, it was not foreseen that this combination of situations could arise. Now that we see that they can, out of the experience of the last couple of years, we need to take corrective action. I am confident that the Congress would never allow those things that come into full fruition, and that these benefits would run away, have such runaway benefit that a great majority of people would be receiving benefits in excess of their past earnings.

Now it is on that possibility the trustees are saying that the system could be broke. But there is plenty of time for the Congress to forestall that possibility. Second, we would recommend that the employer's full payroll should be taxed, and the wage base for workers should be increased to \$24,000 beginning in calendar year 1977.

Now, Mr. Chairman, that was written before your comment, and I can't enter the contest for being mentioned in your dispatches. But I must admit that the 1977 was written on possibly a too pessimistic view of the readiness of Congress to act. We were saying—and that is a kind of self-fulfilling prophecy, I think—if we could act earlier, if it were possible to arouse the Congress to the urgency, the urgency of short-run financing, we would certainly support it.

But we thought 1977 was early. But if it is possible under your leadership to indicate action at an earlier time, we would support it. Now, we think it is appropriate to have a limit on the employee contribution, but that appropriateness does not necessarily carry over to the employer contribution.

Mr. Cohen pointed out the difference in the tax treatment, and that is a relevant factor. But there is another relevant factor, and that is that you are insuring a major portion of the wage for the major portion of the population. Even in 1935 there were some exceptions. They did not attempt even then to insure all of the earnings for all of the workers. It was very high. It was higher than it has ever been since. About 96 percent of workers had all their earnings insured at the \$3,000 limit. That seems incomprehensible now, but that was true as recently as 40 years ago, that 96 percent of workers were receiving \$3,000 or less in earnings.

But even that 4 percent allowed for the exceptional earner, the very high paid, the executive. I remember at the time there were

mentioned the movie stars, and so forth. You are not going to pay a movie star on her retirement 60 percent or 50 percent of her earnings, which might have been thousands of dollars a week.

So there was a limit, and it is appropriate that there be a limit, because the benefit is going to be tied to the base, which is taxed. So there is logic to putting a limit to the taxable earnings, but that logic does not carry over, necessarily, to the employer's tax. And it would be equitable and it would, both because of the tax, different tax treatment on corporate earnings, and the employer's contribution and the treatment of the employee's contribution, to lift the ceiling on the employer's tax and tax it all the way up.

Also if we could do this it would obviate the necessity of increasing the rate, and here is where, of course, I would take issue with the, I think, generally constructive statement of our friends in the NAM.

Representing a group of retired people, now, mostly, we feel that it is important to maintain the kind of family concept that is essential in social security. Social security is a family insurance. It carries the benefits for the wage earner who has died, for his survivors.

It provides for the widow and the orphan of the deceased worker. It takes care of the disabled worker and his dependents. And it is supported by the wage earners of the present generation.

Now, the nice fancy word for this is transfer payment intergenerational or transfers. We don't think of it in those fancy terms. We think of it in terms of family security. So when we are pressing for higher benefits and more security for the retired people we have to be aware that it is our children who are still working and who are paying these taxes.

Consequently we are concerned, as they are, about further increase in the payroll tax. We are not anxious that the taxes on our working children and grandchildren be increased for this program. There will be, we trust, additional benefits added to the social security program as time goes on, and these will need to be financed, and they can't be financed by us who have retired.

But we are anxious that the payroll tax not be increased for these social, as well as economic, reasons. Therefore, we believe it is important to have a larger share of the burden borne by the relatively higher paid worker. This makes the tax as a tax less regressive, and I underscore "as a tax." Because I believe too that the system itself is not regressive.

The tax as a tax only is regressive, and it becomes less so the higher this ceiling on the taxable wage base is placed.

Now, it is true that the higher paid worker does not get a proportionate amount of his contributions paid back in benefits. But here is one of the classic compromises of that system. The workers have been willing, and the higher paid workers have been willing to pay a higher tax for a smaller proportion of benefits, one, because they are willing to bear a part of the social responsibility of all workers, but I think more importantly and more directly because they are willing to pay this price to avoid a system that involves a means test.

They know that the entitlement as a right must carry with it at the lower end of the benefits scale a benefit that is higher in proportion to past wages. Now, if we just made it a straight across the board, say the benefits should be 30 percent of all past wages, the low-paid worker would get a benefit that would be so low that it would be completely

inadequate, and workers have been willing to have that, a higher proportion, to save the high paid worker from the indignity of a means test. It is one to which even though he may be a higher paid worker, he is at risk all the time that he may sometime become a lower paid worker on the average.

If he is ill for a long period of time, if he is unemployed for a long period of time, his average wage when he comes to retirement is going to be lower and he will thus benefit by the higher proportion of benefits.

Now, our third proposal is that the presently scheduled increase in medicare collections of 0.2 percent on employer-employees scheduled for 1978 be allocated to the cash-benefit program. Now, this is practical because if you raise the base you will be applying the percentage to a higher figure and you would have some, you would have some "profit," if I can use that expression, you would have some cushion in the medicare program that isn't needed for medicare benefits. The two of them to be tied together.

Now, in this connection I would like to emphasize our strong opposition to the recommendation of the Social Security Advisory Council that the hospitalization insurance part of medicare be changed from a program of contributory social insurance to one which would be entirely supported by general revenues, and that all contributions now earmarked for hospital insurance be shifted to the support of the cash-benefit program.

I am glad that my associate Mr. Danstedt on that council took a minority position in opposition to the majority view on that point.

We believe, too, that in the long run social security must be financed on this tripartite basis. The principle of your bill, Mr. Chairman, we would accept. But we don't believe that at this time we want to go into general revenue financing on this set of benefits. I think we should reserve that possible resource for a time when we expand the whole social insurance system, primarily to include health care for people of all ages across the board and much more comprehensive health service than we have now.

However, to restore the confidence in the system, which has been eroded in part by this wave of editorial comment, we believe that the provision in the early Social Security Act authorizing payments out of the general revenues to support the trust fund could be well enacted at this time, and this would make a real contribution to the confidence of this system.

Finally, we would recommend a change in the existing legislation to the effect that this social security system be removed out of the Department of HEW and set up under a quasi-governmental authority. Something comparable to the Tennessee Valley Authority, responsible to the Government but not run directly as a Government agency, taken completely out of politics, as it was in fact for a long time.

The political aspect has only been introduced in recent years. But this was simply because the responsible precedents didn't see fit to use it in politics, and you had in the earlier years a bipartisan board administering social security, so that there were those safeguards. But, I think it is also very important to take the financing of the system out of the general budget, of the consolidated budget. I think, the fact, that social security resources and social security expenditure are in there has several bad effects.

One, it has a bad effect on the social security system. It makes social security benefits in competition with every other expenditure of Government. It fails to recognize the unique nature of the funds in the trust fund, and the unique nature of the taxes. Because, while they are taxes in terms of the law, the whole system is in effect a great cooperative enterprise of the people of this Nation using the machinery of Government.

But it is a unique governmental program; in a sense not governmental, in a sense that the people are only using the machinery of Government. The funds, as you know, can't be spent for any other purpose, and to have them all in the consolidated budget misleads the people as to the nature of the trust fund. It misleads the people also in the priorities of our Government.

It enables people like Roy Ash to say, "Oh, you are spending so much more money now on social purposes than you are on other purposes." And the economic indicators that are issued monthly by the Joint Economic Commission shows that, because it lumps these sums altogether with others.

But if you remove these trust fund items, as they were for so many years, then the people get a truer picture of the priorities of this Government, and it shows a higher proportion of expenditure for defense and other items than it does when they are all lumped together. We think it is just the honest accounting to have these funds completely separate.

As a matter of fact, if a private employer were to lump the funds that are in his pension fund, and earmark for the pension fund in his annual report to his stockholders, as a part of the assets of the corporation, he would be in jail, under the present new Pension Reform Act.

But that is exactly what happens when the President reports to Congress, and through the Congress to the people on the condition of the Federal budget. He is lumping funds in there that he can't spend on any other purpose. It is misleading, it has a bad effect on the social security system, and it has a bad effect in terms of our whole understanding of the budget and the priorities of our Government.

For these reasons, I think it ought to be removed.

Now, finally in my paper I make a strong statement for support of retention of the retirement test. I do that, because it is the most widely misunderstood part of the social security system. In these days when we are facing financial problems about the system, those who would remove this test of retirement would in effect be paying a bonus of around \$5 billion a year to that small proportion of older people who are still able to work, and for whom there are jobs in this restricted labor market.

Now, I don't object to \$5 billion being added to the social security system, if we finance it equitably and if it is distributed on the basis of some presumed need.

But to tax the workers of this country and their payroll another \$5 billion a year and hand out a work bonus to General Motors executives and A.T. & T. executives and lawyers and doctors and others who can continue by the nature of their occupation to be at the peak of their earnings at age 65 seems to me to be a misuse of these funds.

One of the things that puzzles me constantly is people charging that this is an unfair provision of the Social Security Act, when nobody raises the question about either unemployment compensation or

private pension plans. Nobody that I know of is arguing that an unemployed worker drawing unemployment benefits when he is offered a job and goes back to work and starts drawing his salary that he should continue to get his unemployment benefits.

And I think it is because they understand that the worker is insured against the contingency of a loss of wage due to unemployment.

We need to make the people understand also that the old age and survivors insurance system is insured against loss of wages due to retirement and he can't have both. He can't not retire and still continue to draw his benefits.

Also I am puzzled by the fact that people don't raise this same charge of unfairness against private pension plans.

I have had something to do in my work of the last 20-some years, before I retired from the A.F. of L.-CIO, with private pension plans. I am now a member of the Statutory Advisory Council under the new Pension Reform Act. I have had occasion to look at I don't know how many hundreds of plans, and I don't know a single plan, a private pension plan, where one can continue on the payroll of an employer after retirement age and get his pension also.

Retirement is a condition of the pension, and quite properly. If it were differently, it would be much more costly to finance. Well, I have stressed this point. It is related to the problem of financing, because if this additional burden were laid on the system now, the burden of what I call, and I believe accurately a work bonus for the minority that are able to continue to work, you would have even a tougher time of financing than the one you have got now.

So, I believe, the pressure that I know many of you are under to remove this test comes from misunderstanding.

I would join with Dean Cohen to say let's all get in and help to broaden the understanding of this system, and then some of these pressures can be relieved.

That would conclude my statement, Mr. Chairman.

I again say I appreciate the opportunity to be here and to present our views and I appreciate your patience in listening to my suggestions and recommendations.

Mr. BURKE. Well, we certainly appreciate your appearance here, because as you know you are highly respected by all the Members of Congress who know about your work down through the years.

Now, the provision of this retirement test, you would not propose a slight increase in that amount of earnings in view of the depletion of the trust fund?

Mr. CRUIKSHANK. Mr. Chairman, I think the built-in increases now make it pretty liberal and we did approve that, I mean, we supported that. But they will go up now as the wages continue to go up, particularly in the present labor market.

You get that much higher and there is the danger of subsidizing competitive work in a restrictive labor market. We have had some experience with that on some of the annuity plans.

Now, annuity, of course, is different from the insurance plan. But we have had a problem with some occupations where people can retire at an early age and draw their full benefits, some of the State and city plans, for example.

Now, we find some of these people ready to go out and take a job

at a reduced wage, competing against somebody that still has to support his family, and they will take that job at a reduced wage because they can still draw that annuity.

I think we ought to be very careful about how we make it possible for this to undercut the wage structure.

Mr. BURKE. What I am getting at is I don't think we should keep the ceiling so low that it is impossible for a person whose benefits are so low that he can't rise above the poverty level if he goes to work.

Mr. CRUIKSHANK. Well, I have suggested at past times in appearance before your committee that retirement be geared to the poverty level, so that a person isn't likely to be forced below that. You have already taken two steps, to prevent this.

Congress has moved in two important ways to prevent this. One is the SSI program. Now, in principle you have put a floor under the income of the aged, the blind and the disabled. The floor is pretty low, and in fact it is below the poverty level. But the principle has been established, and that is very important.

Also, of course, you have tied the retirement test level now to cost-of-living increases, so it will go up. It is now 25 to 20, and also you don't lose all of the benefits. When you get that 25-20, you have to be making something like \$8,000 a year before you lose all of the benefit.

So there is, I don't believe, the disincentive in the present system to working. However, I think that the main thing that we need to do is that if we add these additional costs, increase the benefit, because there are some of the people for whom a job is absolutely impossible, and I would agree with you, Mr. Chairman, there are many people on benefits so low that they are forced below poverty, but very few of them could go out and get a job.

It is the 80-year-old widow who has the benefit, and for her to go into this labor market and to tell her the thing for you to do is go out and get a job and supplement your social security benefit is not what I am sure you intend to do.

Mr. BURKE. Well, what I am getting at is back home in my district, people may have their homes bought and paid for, but real estate taxes are going up to a rate of almost \$200 a month and they are receiving, say, \$200 or \$220 a month under social security. It is absolutely impossible for them to build their home and they take all kinds of harsh steps, cruel steps to try to survive and they have these limitations in the law.

There are still some areas in this country where the cost of living is so high that these limitations prove to be very cruel.

I think that we have to make allowances some way, work out some type of system, some reasonable basis. You can live in a rural area and not need as much income. When people live in their own home, they have raised their family and have lived there for, let's say 30, 40 years, and reached the age of 60 or 70 and, their heating oil bill has doubled, or the rent, or their tax bill has doubled, \$5,000 isn't enough for them to keep body and soul together.

This is a plight that we find hundreds of elderly people in today as a result of this ceiling that is on them.

I go around my district four times a year and invite people in to talk with me, and this seems to be the biggest problem that most of them have, outside of those who don't have a home and are trying to find a place to live.

So, it is something we have to look at and give a little more attention to.

Mr. COTTER. What the chairman has said is absolutely correct, Mr. Cruikshank. I have been around to these various groups. Just a month ago, I addressed an AARP group in Hartford and the one thing on their mind seems to be this retirement test. I get more complaints about that than any other phase of the social security system for the reasons which the chairman has outlined.

These people just have to have another supplemental source of income. They look upon the SSI payments as welfare. These are a proud people who don't want to take these SSI benefits.

What amazes me is that your organization, the members, have not exerted pressure on this.

Mr. CRUIKSHANK. We are very aware of these problems and we share your awareness and we know that you are aware of them.

Mr. COTTER. This is the single chief complaint I get.

Mr. CRUIKSHANK. I think it comes from a misunderstanding of the nature of the system. We might differ on that. The real problem here is that for a very limited group this would help them. You take your people, and I have all of the sympathy in the world and I understand their situation, the people who are, say, 68 years old and they have a social security benefit that is inadequate and they can't, as the chairman said, pay the repairs on their home and all of that and they want to be able to earn a little more money, assuming they could get a job.

Mr. COTTER. To permit them to live in dignity.

Mr. CRUIKSHANK. What is going to happen when they are 80? Are they going to be able to work?

Mr. COTTER. Absolutely not, and as you mention there is such a small segment of them that it seems it is an area where we could accommodate a certain percentage of those receiving benefits.

Mr. CRUIKSHANK. We say it would cost about \$5 billion to remove the test completely and it is our feeling that the answer to the problem of your people is to increase the benefits and not to let that small proportion go out into a competitive labor market.

Mr. BURKE. I could never understand how it costs \$5 billion. When that person continues to work every week they take 5.85 percent from them in taxes, and how long will it take them to get an increase in benefits?

Mr. KELLEY. It is once every year, assuming an automatic-benefit increase.

Mr. BURKE. They get the taxes out of them for a whole year, which improves the fund. Then if they take \$1 out of every \$2 over that \$2,520 he makes, that is a double whammy on them.

He is paying 5.85 percent tax, and if he makes another \$100 they take \$1 for every \$2 out of that that he earns, so they tax him again. It looks to me like the Government picks up some money there and yet they come in and tell us that they lose \$5 billion or \$6 billion.

Mr. CRUIKSHANK. Well, they pick up some but there are a substantial proportion, and I don't know just how big it is, of people that have not retired over age 65. They would all immediately start drawing full benefits and a very high proportion of those are at the top of the benefit list.

Mr. BURKE. We are not advocating removing the ceiling.

Mr. CRUIKSHANK. That is where the \$5 billion comes in.

Mr. BURKE. I don't think it is fair or just for persons who have worked all of their lives and paid their bills all of their lives and finally when they reach the age of 65 and they get a check of about \$220 per month to say to them, "Now, if you go to work and you earn over \$2,520 this year, every \$2 over that you earn we are going to take a dollar out of your social security check." At the same time the local government turns around and increases their tax bill by \$200 or \$300. They get an increase in their utility bills by a couple of hundred dollars, and an increase in their food bills and everything else. And then to have a system like this? To me it seems to be an awfully poor way. I can understand people being so concerned about it.

I should think this year we could increase that ceiling from \$2,520 up to about \$3,500, and what would that cost the fund?

Mr. KELLEY. I can't give you a cost estimate right now.

Mr. BURKE. It is about \$700 million, but they would have to pay income taxes and they would have to pay other things and there would be more money in circulation to help the economy. People would get their bills paid, and the utility companies would be happy, and they wouldn't have to shut off the electricity from these homes the way they have to do now.

Mr. CRUIKSHANK. I don't want to leave the impression, Mr. Chairman, that we are insensitive to this need. We are not at all.

Mr. BURKE. I know you are not, and I think that somebody down there at Social Security has sold somebody a bill of goods someplace that they can't increase this a little more than they are increasing it and they scare the devil out of you by telling you there is a \$5 billion loss.

I am not saying to remove the ceiling but I think with the cost of living and everything going up we have to make adjustments. My oil bill in my house back home went up from \$310 for 1972 to \$796 last year. I am wondering what some of the people in the neighborhood with the same size home are doing. We have the thermostat turned down to 60 degrees and my two elderly sisters walk around with sweaters on.

Some of these elderly have real problems, particularly those people whose children have gone off and left them alone. They are living in these old houses, the roofs are leaking, and they are trying to just maintain life with a little bit of dignity. And the Federal Government comes in and says, "Look, you earn \$2 more than \$2,520 and we are going to take \$1 out of your social security check."

It looks like the "grim reaper" is trying to cut them down before they get into the graveyard.

Mr. CRUIKSHANK. I am saying, Mr. Chairman, I do want to emphasize that we are fully sensitive to the problem of the need as we make adjustments. We just want to be sure that the adjustments take into account the total need and that we don't spend a lot of the money leaving out the poor older person who can't possibly work.

To keep principle clear, I know you are not arguing for the removal of the rest entirely, but in terms of the principle, suppose we did, and then these people that were in your AARP meeting—

Mr. CORTER. I cited that as the most recent example.

Mr. CRUIKSHANK. Whether they are in the National Council it does not make any difference, but people who are saying, "If you can let me earn more money and get my social security," then when they got to be 78 or 80 years old, they would find themselves on a

lower benefit than they would be had they not had this. They are spending their money in advance.

Are we spending it in the areas of the greatest need? That is the only question that we raise.

Mr. COTTER. Have you told your membership of this problem?

Mr. CRUIKSHANK. Yes; this has been before our board and before the floor of our convention, and it has been debated, and they support this position.

Mr. BURKE. The next time I go around to my district, I wish someone from your organization would come in and sit down and listen to some of these people. You will find out that they are not people out looking for big jobs, but they are trying to hold on to enough to keep body and soul together.

Mr. CRUIKSHANK. It is a question of the allocation of your resources, and I am sure we all want to do it in terms of meeting the largest need for the greatest number. On that, I am sure there is no difference around this table.

Mr. BURKE. Most of these people, too, you will find are really suffering. In the elderly group on social security are people who have worked all of their lives and have a lot of pride. They don't want SSI or anything else, and they don't mention a word to a soul in their neighborhood. They are a very proud people, but they really suffer.

I think that this great Government of ours, with all of the money it spends, I think maybe that general revenue might have to come about to see that these people who have always worked all of their lives and never asked the Government for anything but what they should be entitled to, should not be penalized until they enter the graveyard.

I think that is what might happen to this \$2,520 ceiling this year.

Mr. CRUIKSHANK. That will go up, too.

Mr. COTTER. I have one question, too, Mr. Cruikshank.

In your testimony you mentioned that you would like to see the administration established as a separate entity similar to the TVA and similar to the Post Office Service.

Mr. CRUIKSHANK. I hate to use the Post Office as an example.

Mr. COTTER. That is what I am trying to bring in. You mentioned political interference and so forth. What is the nature of this interference?

Mr. CRUIKSHANK. Well, there were some outstanding examples in 1972 when the 20 percent increase went into effect. I get social security, myself, every month.

Incidentally, I lost social security for several years because I was working; and I believe in this retirement test so much I was willing to lose it myself. But in the checks there was a little slip included which came out in September, the most critical week before election, saying that this, in effect, was a bounty of the President of the United States naming him by name.

This, to my knowledge, had never been done before.

Mr. COTTER. It shouldn't be done, be it Republican or Democrat.

I wasn't here in the days when the Post Office Service was under the Government, but admittedly there was a great deal of political interference. But I think, since that time, the vast majority of the employees there and most of the American people would prefer to see it back under politics.

I would hate to tell you the number of cases which I have in my office, maybe half a dozen a day, where someone has complained about not getting a check or a dispute with the local office or something, which my office and every other congressional office here has been able to resolve.

You take it away from politics, and you take it out of Government and set it up as a separate agency, and you lose all of these benefits, and I think it is important to the people. It is a headache to me, but by the same token it is comforting to be able to get a check in the hands of a recipient or help him with his benefits or whatever it may be.

I think once you lose this, you have lost an awful lot.

Mr. CRUIKSHANK. I wouldn't want to lose that. I think you could have the best of both systems. I said a quasi-governmental agency, and I used the Tennessee Valley Authority as an example. I think, if you would remove that, it would be the main advantage. The main advantage would be to get it out of the consolidated budget.

I think a bipartisan board is also important. These might be able to be accomplished, these ends, without changing the fundamental nature, I don't know. But it seemed to us that that was the most efficient way of achieving these ends, to set up the quasi-governmental authority.

I know there are advantages, and we turn to Congressmen for help all of the time.

Mr. COTTER. These are acts we are delighted to do, because you are helping people in need.

Mr. DANSTADT. I couldn't pinpoint it exactly, but I felt a lot of the shots were being called out of the fifth floor of HEW because it was a unit there, and it sort of puzzled me because this was the largest operation in HEW.

Mr. COTTER. I know it should be taken away from HEW, but anything that would resemble something like the Post Office Service, I wouldn't agree.

Mr. Karth, do you have any questions?

You never know what is going to be on the floor, and as a result we are running from one to the other.

Mr. KARTH. If the distinguished chairman could tell us how to be in two places at once, he could solve some of our problems.

Mr. CRUIKSHANK. That energy problem is of very real interest to all of us.

Mr. KARTH. Mr. Chairman, I move we adjourn, subject to the call of the Chair.

Mr. COTTER. Thank you very much. The committee stands adjourned.

[The following was submitted for the record:]

STATEMENT OF ANDREW J. BIEMILLER, DIRECTOR, DEPARTMENT OF LEGISLATION, AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

Mr. Chairman, we appreciate the opportunity to present our views on the financing of the social security program. There is no need to remind you, Mr. Chairman, of the tremendous importance of social security to Americans of all ages. You have participated in the development of the social security system for many years as a key member of the House Ways and Means Committee. And we know that you have always been receptive to proposals to improve social security, to broaden it, to make it serve the needs of the American people more adequately—provided these proposals did not endanger the basic soundness of the system as a whole.

In recent months, numerous magazines and newspapers have reported on the financial troubles of the social security system. These articles stem from recent reports of the Board of Trustees of the Social Security System that the program is faced with a short-term and a long-term actuarial deficit. Many of them have been distorted and exaggerated. Understandably, many of our members, active and retired, have expressed their concern to us and have inquired whether the trust funds will be sufficient for their retirement years.

The AFL-CIO has a deep concern about the financial soundness of the social security program. Nearly half the money that goes into the trust funds represent the hard-earned wages of American workers. Workers and their families are by far the largest group of beneficiaries. Whether the amount put into the trust funds will be enough to pay the benefits workers have earned is not a matter we take lightly. But we do not accept unfounded allegations that the system is bankrupt now or will be in the future. The AFL-CIO Executive Council adopted a statement on the financing issue in February of this year, and I respectfully request that it be included in the record of the hearings.

The fact that contribution income is less than the outgo for benefit payments for a year or two should not be a cause of major concern. A major reason social security trust funds exist is so that they can be drawn upon during such contingencies. In addition, the fact that beneficiaries are receiving more money to spend than is taken in payroll taxes has had a positive effect in stimulating a depressed economy. However, this deficit cannot continue indefinitely and some action must be taken to insure the future financial stability of the OASI trust fund. In making provision for additional social security financing, we believe it important for Congress to time effective dates so they will harmonize with other efforts to stimulate the economy. But more important is the need to act as soon as possible on the financing issue in order to maintain public confidence in the system and to bring peace of mind to millions of our retired citizens.

The short-run deficit has resulted from two major causes. First, a much greater than projected inflation rate that has triggered higher cost of living benefit increases relative to income from increasing wages. Second, a much higher than expected unemployment rate has curtailed expected revenues. In short, benefit costs are more and estimated revenues are less. In our opinion, the short range problem is easily manageable and would not be a major concern if it were not for the long range problem.

The long run problem, which develops largely in the 21st Century, arises primarily from the assumptions of the most recent trustees' report that the fertility rates of recent years—the number of children women are expected to have—will continue for a period of time and then stabilize at 2.1 which is approximately the rate that will eventually produce zero population growth. If correct, this means that starting about 30 to 35 years from now, there will begin to be a sizable increase in the number of retired persons relative to active workers. In short, fewer people at work will have to support more retired people than previously estimated.

The AFL-CIO has a number of specific suggestions for resolving the short and long run financing problems of the program. At the same time, we reject the contention that concentration on the financing problems precludes program improvements.

One approach for resolving the short run problem and which would also help the long run situation is to raise the wage base and increase the maximum amount subject to the payroll tax and used for the computation of benefits. The taxable wage base should be gradually increased, in addition to the automatic adjustments, so that approximately the same proportion of workers will have their full wages covered as were covered when the social security law was first enacted. About 97 percent of the persons in the social security program had their full earnings covered when the program first began. It would take a wage base in excess of \$28,000 to cover the same proportion today.

The increase in the contribution rate is not only important as a means of financing the program and reducing the regressivity of the tax. The social security system is important to high wage earners as well as to those with low incomes. An increase in the wage base will mean higher benefits for those who pay on the higher amounts.

A higher wage base along these lines would greatly over-finance the Medicare hospital insurance (Part A) for many years. The Medicare payroll tax increase of 0.4 percent of payroll, now scheduled for 1978, should be transferred to the cash benefit program.

The AFL-CIO urges complete removal, in the case of employers, of the limit on wages subject to the payroll tax. The employer portion of the tax is based on the

assumption that the employer has a responsibility for paying not only wages but also a deferred wage to help maintain workers and their families when their working days are ended. An employer's responsibility for the welfare of his employees should be related to his total payroll rather than to just a part of each employee's earnings. In many countries, the employer either pays social security contributions on the total earnings of employees or his social security taxes are larger than are the employee's taxes.

In addition, the employer tax is a business expense and as such is deductible from the employer's income tax. It plays no role in determining the amount of the worker's benefit and there is no logic for not applying it to the total payroll.

But the best way to improve the financing, to head off any further increases in the payroll tax, and at the same time, make necessary improvements in the program is to add a government contribution out of general revenue. Without general revenues, the payroll tax required to achieve these objectives would place an unfair burden on the worker since, considered solely as a tax, this contribution is regressive. The United States is one of the few advanced industrial nations in the world in which the social security system is financed entirely from payroll taxes.

There has been support for a government contribution from general revenues from the inception of the program. Organized labor supported the payroll tax at the time the social security program began despite its burden upon low income workers. However, organized labor and many other supporters of this legislation viewed exclusive reliance on the payroll tax as a transitional stage.

Mr. Chairman, if you will examine the record of the past you will find that in these early years the Social Security Board, Advisory Councils, Congressional spokesmen, organized labor asserted the need for a general contribution as some appropriate stage in the development of the system. Organized labor believed, as did many others, that exclusive reliance on the payroll tax was necessary during the initial phase of the program in exchange for the benefits of the new protection. But, at the same time, we felt that ultimately action would be taken to limit the burden upon low and middle income groups.

In fact, the original social security legislation submitted to Congress in 1935 recommended a government contribution to cover past service credits and even mentioned 1935 as the most likely year when such contributions would be required. Provisions for a government contribution were actually included in the Social Security Act from 1944 to 1950 and though removed in the amendments of 1950, its removal was against the recommendation of the Advisory Council on Social Security.

In addition, government contributions are already being used to meet a minor but nevertheless a significant portion of program costs—wage credits for military service, hospital insurance for the non-insured, matching funds for the Part B premium, and for the age 72 special benefits. In short, Mr. Chairman, this is not a new proposal but an old one that now needs to be more fully implemented.

Raising the wage base, taxing the employers total payroll, and shifting the scheduled Medicare tax increase to the cash benefit program, would provide more than enough income to resolve the financial problems of both the cash benefit and the Medicare hospital insurance programs until the end of this century. If combined with some general revenue financing, major improvements could be made in the programs as well.

At this time, I would like to discuss the long-term financing problem—a problem which develops largely in the next century. The primary factor causing this problem is the decline in the fertility rate. The low fertility rate, if it were to continue at levels estimated by the trustee's report, could have a serious impact on the financing of the social security program. This would occur because the proportion of workers supporting beneficiaries will likely be much less in the next century. In other words, a higher proportion of the nation's production by active workers will have to go to support older people—assuming the two groups maintain the same relative living standards that now exist.

On the other hand, the increased portion of the nation's production that will go to the retired population will be offset by a decline in the number of younger people being supported by the economy. There will be less expenditures for supporting children, for schools, for day care, etc. and society can shift these economic savings to supporting the larger older population. In short, in any society, the population at work has to support those that can't work. Looking at the total economy, the economic burden for active workers will not really change much. There will be a reduction in the need to support younger people roughly balanced by an increased need to support older people.

The financial gains that accrue to society as a whole by these compensating factors are little reflected in monetary gains to the program itself. Thus, the

financial problem is not one faced by the nation or economy as a whole but arises from the circumscribed manner in which the social security system is financed. The system is based on a payroll tax on active workers and on employers. Exclusive reliance on this tax, if the ratio of retired people to those at work increases significantly, will require major increases in the tax to support them.

The problem is how to route some of these financial gains to society from a declining birthrate to the social security program to help pay for the higher costs required to support the elderly. Considered solely as a tax, the social security contributions are highly regressive on wage earners. It would be unfair to place the entire increased burden of supporting the elderly on wage earners and income. The best way to achieve greater tax equity and to translate financial gains elsewhere in the economy to increased revenue to the program is by general revenue contributions to the trust funds. We urge gradually increasing contributions from general revenues until at least one-third of the social security program is financed in this manner and, if the long run financing problems actually begin developing as now projected, they should be absorbed within this funding.

There is one thing that should be done now that would significantly hold down costs in the next century and yet would not undermine commitments already made. This would be to "decouple" social security benefit levels. The 1972 amendments provided for the automatic adjustment of retiree benefits in accordance with increases in the cost of living. The amendments also provided simultaneous cost of living adjustments of the benefit table in the law. At the same time, workers' benefits are going up as their wages rise. The combined effect can result in long run benefit entitlement increasing at a rate more or less than the increase in wages depending on the relative movement of prices and wages.

Mr. Chairman, workers do not expect benefits higher than their wages when they retire and they certainly do not want to be taxed for such an anomalous objective.

What they do want is the assurance that the benefits they receive will be fairly related to their earnings before they retire and will be sufficient to meet their needs. The AFL-CIO therefore regards the present formula, which creates uncertainty as to ultimate benefit levels, as an unanticipated technical flaw which we are fully prepared to have removed from the law and, indeed, we strongly urge that this be done.

We believe the most sensible course at this time is for the Congress to enact those changes recommended by us which will assure the financial soundness of the social security system for the next 25 or 30 years and which, at the sametime, will allow for major improvements in the program.

Many of our suggestions would do much to resolve the long range financing problem which may not develop as now projected. We should not try to totally solve the long range financing problem but wait until we are able to judge the most important variables with a greater degree of certainty. There is still plenty of time in which we can determine the extent to which present projections are valid and to take corrective action. Very small differences in economic and demographic assumptions can lead to great variations in estimating the long-term cost of the social security program.

Experience has shown that projection of future population growth has often been wrong. Demographic experts always draw attention to the uncertainties which surround their assumptions and emphasize that it is not possible to make firm predictions.

Because of the convergence of several recent factors affecting family formation and child-rearing decisions, it is probably too early to tell whether the recent drop foreshadows a long-term decline in the birth rate. Unemployment and reduced income traditionally encourage lower birth rates. The speed at which the drop occurred suggests that postponement, rather than abandonment was the cause. In fact, census surveys showing that women are planning to have an average of a little more than two children each suggest that current birth rates are below what the long-term trend will be.

On the other hand, it is quite possible that improved methods of contraception, a tendency toward marriage and child-birth at later ages, cultural changes in the role of women and a general concern with environment and over-population may cause a decline in the birthrate even greater than now anticipated.

Even if the most pessimistic birthrate forecasts occur, it does not necessarily follow that there will be a proportionately smaller future labor force to support social security beneficiaries. A smaller labor force may mean a greater demand for labor. Experience has shown that the supply of workers expands to meet demand. Many older people now forced into retirement may be able to continue working. Smaller families may bring more women into the labor force than is now predicted

since there will be fewer years when they are caring for small children. We will likely drive down our excessive unemployment rates closer to those of most other industrialized nations so that more people will be working and paying into the trust fund. We may achieve future productivity increases of 2.5 or 3 percent a year instead of the pessimistic 2 percent assumed in recent cost estimates. Very minor variations in any of these factors when compounded over a period of 75 years would have a major impact on the cost of the social security system.

We hope our statement concerning the financing of the social security program has been helpful. We hope it demonstrates a need for concern, but no reason for alarm. The trust funds are doing the job they were intended to do—to carry the social security system through periods of economic difficulty. We are certain that American workers can have every confidence that this Committee and Congress will act quickly not only to remedy any financial difficulties but will continue to improve the program.

STATEMENT BY THE AFL-CIO EXECUTIVE COUNCIL ON SOCIAL SECURITY—
BAL HARBOUR, FLA., FEBRUARY 17, 1975

Forty years ago America made a commitment of economic security during retirement to the workers of this nation through the Social Security program. That commitment broadened over the years and now includes protection for widows and children, disabled workers and their dependents, and health care for those over 65, the severely disabled and kidney disease victims.

Social Security has survived many challenges over the years, but at no time has there been more controversy about the program than now.

Social Security touches the life of practically every American. Thus, responsible debate concerning the program is an appropriate and an essential part of the democratic process. In this way, the program can be adapted to meet the new and changing needs of the American people.

Regrettably, much recent criticism of Social Security has been alarmist, distorted, and inaccurate. It may be part of a general campaign program in order to impede essential improvements or inspired by opponents of National Health Security who seek to discredit Social Security since Health Security would be based on social insurance principles.

Exaggerated claims of an alleged lack of financial soundness of Social Security have cropped up from time to time since the program began. But the 1974 report of the Social Security trustees gave new impetus to these over-blown charges. The 1974 report was greatly distorted by some publications and newspapers into false stories that Social Security is bankrupt.

Relying on the most recent census data, the report projects a long-term actuarial deficit in Social Security Trust Funds, due largely to anticipation of a greater than expected decrease in the nation's birthrate. This creates no short-range financial difficulty that cannot easily be handled because the lower birthrate would have no major impact until the 21st Century. However, the report added, if current birthrate projections hold, additional financing would be required.

The AFL-CIO is deeply concerned about every aspect of the Social Security Program. Workers' payments represent nearly half of the money in trust funds. Workers and their families are the overwhelming majority of beneficiaries. We do not take lightly the question of the program's financial soundness. However, we reject misleading allegations that Social Security is bankrupt or will be in the near future.

To alleviate the anticipated long-run deficit, the following steps should be taken to provide additional funds:

The taxable wage base should be gradually increased until the same proportion of workers have their full wages covered as were covered when the Social Security law was first enacted.

Presently, the full wages of about 85 percent of workers are covered, compared with 97 percent when the program began. This requires raising the base, over a period of years, from the current \$14,100 to \$28,000.

The Social Security tax should be applied to the total payroll of employers. The wage base is appropriate for individual workers since it determines the level of their contributions and benefits. There is no similar need for a wage base limitation on the employer's payroll. The tax burden on employers is less actually now than contemplated by the original Social Security Act. It provided for an ultimate, combined employer tax rate for Social Security and unemployment compensation totalling 6 percent. Because of the lower proportion of wages now covered, ex-

perience rating under unemployment compensation and the increased tax deductible advantages now available through corporate tax laws, the tax burden of employers is now significantly less than that provided by the original law.

Congress should consider replacing the present benefit structure with a formula relating benefits to retiring workers more closely to their wages in the years nearest retirement. The 1972 amendments made provision to adjust benefits of retirees automatically in accordance with increases in the cost of living. These amendments also provided that the future benefits in the law relating to current wage earners would be automatically upgraded as wages and prices change. Under present law, benefits to be paid to future retirees may increase at a rate more or less than wages depending on the relative movement of prices and wages. We urge consideration to a new approach that would, for example, relate benefits to a high 10 years of earnings and eventually a high 5 years, as is done in many private pension programs. The long-range cost of this might be less than current estimates indicate, and workers' benefits would better reflect wages at the time of retirement.

The AFL-CIO rejects the contention that improvements in the Social Security Program can not be made during the current economic difficulties.

We also categorically oppose the Administration's budget philosophy of ignoring essential human needs. Therefore, we will vigorously oppose the pending Administration proposal to cut back the Medicare program and to hold the scheduled cost of living increase to 5 percent. The victims of the Administration's economic mismanagement must not be forced to make additional sacrifices.

These recommendations would raise substantial additional revenues, but not enough to eliminate both the estimated long-term actuarial deficit and, at the same time, make needed benefit improvements. Raising the payroll tax, however, is not a feasible solution because it would place too great a burden on low and middle-income workers.

Workers' real wages are lower now than they were in 1965. Working families are hard pressed to make ends meet because of unemployment and rapidly rising living costs. Clearly, they should not have to bear the burden of additional Social Security taxes. Instead, needed additional funds should come from general tax revenues.

The AFL-CIO reaffirms its position urging relief for low and middle-income workers from the burden of the payroll tax. This relief is best accomplished by payments from general revenues to low and middle-income workers totally separate from the financing of the Social Security system in the manner of other governmental subsidies. The Social Security trust funds would continue to receive payroll taxes from these workers. They, in turn, would be compensated from general revenues for part of their payroll taxes.

Contributions from general revenues to the Social Security Trust Funds should gradually increase until at least one-third of the program is financed by this source. Many European countries use general revenues to supplement employer-employee taxes in financing their social insurance systems. This is not a new concept for the U.S. Social Security program. The Committee on Economic Security, which developed the original Social Security law, considered that such a general revenue contribution eventually would be needed. Indeed, the original Social Security legislation submitted to Congress in 1935 contemplated an eventual government contribution.

The principle of a general revenue contribution already has been accepted since some general revenue funds are being used to pay for benefits based on wage credits for military service: hospital insurance benefits for non-insured people, special age 72 benefits, and half of the cost of the Supplemental Medical Insurance Program (Part B) of Medicare.

Using federal general revenue for Social Security is not a radical concept, rather it is an old idea that has not been fully and properly implemented.

In addition to our recommendations for strengthening the financing of the Social Security System, the AFL-CIO urges the Congress to enact the following improvements in the program:

Social Security benefits should be adjusted for inflation at least every 6 months whenever the Consumer Price Index has increased by 3 percent or more, instead of the present system of no less than annually. When the escalator provision was adopted, price increases were expected to be moderate and an annual adjustment considered satisfactory. Raging inflation has had a disastrous impact on the living standards of Social Security beneficiaries; their already inadequate incomes falling far behind skyrocketing prices. Therefore, in addition to speeding up future cost-of-living benefit increases, Congress should enact an immediate cost-of-living increase.

More than 80 percent of the purchases of the elderly—and an even greater percentage of the poor elderly—are for food, housing, medical care, and transportation, which are some of the fastest rising items in the Consumer Price Index. Therefore, we believe that in addition to the present CPI, a special index for the elderly and poor should be developed to more accurately reflect changes in their living costs.

Early retirement at age 60 should be permitted but with less than the present full actuarial reduction in benefits. This would substantially improve benefit levels for early retirees, most of whom are forced out of the labor market by illness or loss of jobs and find it impossible because of age to compete for jobs especially when, as now, there is high unemployment.

An occupational definition of disability for workers age 55 and over should be provided in recognition of the fact that older workers with a disability who lose their jobs have virtually no chance to obtain employment in a new occupation. The program now considers a worker disabled only if he or she cannot engage in any kind of substantial work, regardless of whether there is such work in his or her area, a job vacancy exists or if he or she would be hired. This is an unrealistic definition for older, disabled workers who must compete in a labor market with high unemployment rates.

Pending enactment of National Health Security, Medicare should be expanded to provide a greater range of health services to Social Security beneficiaries. With out-of-pocket payments the aged pay for medical treatment now much higher than before Medicare became law, it is urgent that the financial burden of Medicare costs be reduced. The AFL-CIO urges the following improvements in Medicare:

1. Eliminate the monthly premium beneficiaries must pay for Part B (physician services).

2. Includes coverage of prescription drugs.

3. Reduce the present two year and five month waiting period that the disabled must meet to be eligible for health benefits and start Medicare coverage after 5 months when cash disability benefits begin.

Social Security has served America well. It will continue to do its job well if the changes we have recommended are enacted. These changes can only come in an atmosphere of responsible, constructive debate.

The AFL-CIO will join that debate, and we will challenge irresponsible, misleading attacks on Social Security by those who cynically seek to undermine this vital social insurance program.

STATEMENT OF ANDREW A. MELGARD,* CHAMBER OF COMMERCE OF THE UNITED STATES

SUMMARY STATEMENT

1. This statement on financing the social security system is submitted for the membership of the Chamber of Commerce of the United States, 1615 H Street, N.W., Washington, D.C. 20062, by Andrew A. Melgard, the Director of the Chamber's Economic Security, Education and Manpower Section.

2. The membership of the National Chamber includes over 48,000 business enterprises and over 3,600 trade and professional associations, local and state chambers of commerce. The underlying membership is more than 5,000,000 individuals and firms.

3. Topical Outline and Summary of Comments and Recommendations.

A. Current National Economic Problems and Social Security

(1) Recovery and Resumption of Economic Growth without Inflation—The Nation currently faces three difficult problems: The severe recession and resulting unemployment, the continuing inflation, and the energy crisis. The main short-term goal of economic policy should be to slow down inflation while alleviating the burdens of recession. A resumption of economic growth will require more capital formation. A continuance of tax policies directed toward more income transfer will not prevent a recurrence of overconsumption.

(2) Confidence, Stability, Taxes and the Middle Class—Congress and the Administration need to restore confidence in our economy and the Federal Government, to set us on the path to stable economic and social advance and more personal freedom. "Amazingly, the biggest increases in the middle-income

*Director, Economic Security, Education and Manpower Section, Chamber of Commerce of the United States.

family's budget resulted from higher social security and income tax payments." Further, social security tax increases imposed before we are out of the recession and have controlled inflation could lessen people's confidence in government.

(3) The Social Security System and Its Underlying Principles—Employers will continue to pay their fair share of social security taxes. To maintain confidence in the social security system, Congress should adhere to the basic principles underlying it: a floor of protection, self-supporting financing, benefits paid because of job-income loss, benefits paid in cash, no needs test, and wage-related benefits.

(4) Reappraisal of the Social Security System—A complete reappraisal of the social security system is needed. More public enlightenment is needed. There must be a clear understanding of how the system works and what it costs to assure continuing public support.

B. Short-Term Social Security Problems and Issues

(1) Background on Anticipated Deficits—In four years, we have gone from actuarial soundness to short-term deficits and anticipated long-range deficits in financing the cash benefits program.

(2) Short-Term Financing Problem—The short-term financing problem is serious and requires early attention. Fortunately, social security trust funds total over \$50 billion, and earned about \$3 billion in interest in 1974.

(3) Chamber Recommendations—The trust funds should be used for the purpose for which they were created and amassed—to tide us over this year and next until we can come out of the recession and increase employment. A payroll tax increase this year or next could be counterproductive, impede recovery, and hurt employment. The Committee, while determining the amount and timing of any social security payroll tax increase, should address the following issues: decoupling, universal coverage, inequities, treatment of men and women, and private pension encouragement.

C. Long-Range Social Security Problems and Issues

The long range gap in social security exceeds a trillion dollars. In dealing with this problem, the Chamber recommends Congress review all of our economic security and income maintenance programs.

(1) The "Welfare State and Transfer Economy"—The growth of the "welfare state and transfer economy" may be weakening the linkage among work, personal property and income. Such linkage is necessary for the efficient operation of the marketplace. The costs of welfare and transfer payments, and their expected growth, will affect the growth of employee wages and benefits.

(2) Trends in Corporate Wages and Salaries, Supplements and After-Tax Profits—Everybody grossly overestimates business after-tax profits. The long term trend over the last six business cycles has been downward for after-tax profits as a percent of corporate wages and salaries, and upward for supplements (employee benefits) as a percent of such wages and salaries. These facts raise serious questions about the future rate of growth of employee benefits.

(3) Employee Benefits (1963 to 1973)—Over the last 10 years, the cost of employee benefits has tended to rise almost twice as fast as the cost of increased wages and salaries. In 1973, employee benefit costs averaged \$62.12 per employee per week. There were wide variances from industry to industry, and from company to company within industries.

(4) Conclusion—Our income maintenance systems are complex and there are limitations on paying for them. Any long-range study of social security must consider all relevant income maintenance systems and their costs.

The Chamber of Commerce of the United States welcomes this opportunity to present its views on our social security system and its financing.

This issue is of vital concern to our membership which embraces more than 48,000 business enterprises, 3,600 trade and professional associations, and local and state chambers of commerce. The underlying membership is more than 5,000,000 individuals and firms.

These comments are under three major headings, as follows:

1. "Current National Economic Problems and Social Security."
2. "Short-Term Social Security Problems and Issues."
3. "Long-Range Social Security Problems and Issues."

CURRENT NATIONAL ECONOMIC PROBLEMS AND SOCIAL SECURITY

Recovery and Resumption of Economic Growth Without Inflation

The Nation currently faces three difficult problems: the severe recession and resulting unemployment, the continuing inflation, and the energy crisis. The

Chamber recognizes that there is no easy or quick solution to these problems, but has developed a comprehensive set of recommendations for national policy against recession and inflation. A coordinated approach to both recession and inflation is imperative.

The main short-term goal of national economic policy should be to slow down inflation while alleviating the burdens of recession, particularly unemployment. Recovery in a less inflationary environment will lay the basis for longer term economic progress. Recovery with high-single or double-digit inflation will not. The clear aim is to increase employment now and to encourage the movement to recovery without rekindling inflation.

There is some evidence that the recession is bottoming out. Congress and the Administration have moved through the complex Tax Reduction Act of 1975 (P.L. 94-12) to stimulate the economy. The Budget and Impoundment Control Act of 1974 (P.L. 93-344) gives Congress a process for controlling the budget which has the support of the Chamber and the business community. Hardships experienced by those unemployed by the recession should be relieved, but compared to recessions of comparable severity in the past there are now more cushions to such unemployment in the form of extended unemployment compensation, supplementary unemployment benefits, public service jobs, food stamps and other programs.

There is some danger, however, in the current discussion of anti-recession policies in overlooking the need to encourage savings and investment. A resumption of economic growth will require more capital formation. A continuance of tax policies directed toward more income transfer will not prevent a recurrence of the overconsumption that has characterized our economy—indeed, all western economies—during the past several years. If we fail to encourage both individual and corporate savings and investment, which will result in the new capital formation needed for job creation, it is difficult to see how we can reduce the current unemployment rate to a reasonable level and, at the same time, provide jobs for the millions of young people who will enter the work force this year and in the next few years.

Confidence, Stability, Taxes And The Middle Class

Beyond accomplishing recovery and economic growth without inflation, Congress and the Administration have a deeper need to restore confidence in our economy and the Federal Government, to set us on the path to stable social and economic advance and more personal freedom. Inflation, reports a leading business magazine, is squeezing 53 percent of the nation's 55 million families—the middle class—into the "high poverty" class before our eyes, not to mention how the same insidious and deceptive tax hits the poor, which is worse.

No one has to tell the middle class that in the last two years the value of the dollar has shrunk nearly 20 percent, the value of household savings and other assets has shrunk 11.5 percent, and household debts have risen 18.6 percent. These families, having incomes roughly from \$10,000 to \$35,000, are the huge group of "middle Americans," hard-working family people who give stability to the values and aspirations of the nation. They buy 75 percent of consumer products. And they pay a lot of our taxes, including heavy social security taxes.

While no one has to tell the middle class that taxes have risen, the Joint Economic Committee recently reported its astonishment at this discovery in the report, "Inflation and the Consumer in 1974." The report stated: "Amazingly, the biggest increases in the middle-income family's budget resulted from higher social security and income tax payments." The U.S. people are a whole lot less amazed. They don't need reports to tell them that inflation is pushing them into higher tax brackets while Congress plans to raise social security taxes higher.

People don't even need to be told, either, that government at all levels, now a third or more of the economy and rising, gets more unwieldy and works at cross-purposes even as it looms larger in people's lives. And people need nobody to tell them that the inflation squeeze has hit state and local governments, now likely to push up their taxes just when the federal government has dipped deeply into the red ink to cut federal taxes. Recent surveys show the rise of a new conservation ethic in America, a sharpening of disappointed people's political sensibilities, more open criticism of government agencies, and more desire by citizens to be involved in what affects their lives.

If under these circumstances, and before we are out of the recession and have controlled inflation, Congress moves to increase Social Security taxes on employees, employers and the self-employed, people's confidence in government could lessen. This is especially true in the social security area where employees and employers

have already been taxed for many years to build up a contingency social security fund to be used when we have severe and unresolved economic problems such as we have now.

Overall, the National Chamber believes there is a vital need now to study the appropriateness of measures used to maintain stability in the economy and to evaluate the whole question of the size and role of the public sector in a society basically committed to private ownership and a market economy.

The Social Security System And Its Underlying Principles

Social security benefits are an important, often essential part of income maintenance for millions of retired Americans, surviving widows and children, and the disabled. At the same time, the majority of working Americans, their spouses and children expect future benefits from the system.

Since enactment in the 1930's, employees, employers and the self-employed have supported the system. Employers will continue to do so, and to pay their fair share in financing the system through payroll taxes.

Congress needs, however, to maintain public confidence in this great social insurance system and the manner in which it is financed. To do so, the Chamber recommends continued adherence to the following basic principles that have guided the development of the cash benefits program:

- that the purpose of social security is to provide a basic floor of protection and not complete income maintenance;

- that the system should be self-supporting based on equal payroll taxes from employees and employers and by taxes on the self-employed, periodically adjusted to support benefit disbursements on as current a basis as practicable. General revenues should not be used to finance regular program costs;

- that benefits should be paid when there is job-income loss; i.e., that there be a "work" or "retirement" test, at least to age 72;

- that benefits be paid in cash, not in kind, so that individual freedom of choice is maintained and recipients are able to use social security and any other income as desired to satisfy their needs and wants;

- that benefits be paid as a matter of right, and that the eligible recipients not have to meet a "needs" test;

- the benefits be wage related or based on the worker's past earnings record.

(It is recognized, of course, that Medicare for obvious reasons departs from several of these principles: Medicare provides that the worker at 65 and thereafter will have certain specified health care services paid for and will not receive cash, will receive these services without regard to a work test, and will receive a flat or uniform benefit not related to wages or earnings.)

Reappraisal of the Social Security System

Social security is not a static system. Since its enactment in the 1930's, it has been a growing and expanding program. Growth has occurred in the number of persons taxed to support the system, the number of persons receiving benefits, the dollar amount of individual benefits, and the type of benefits. By the end of 1974, about \$6 billion a month in benefits, including Medicare, was being paid to over 30 million people. In short, the system has matured.

Throughout this period, social security benefit increases have been kept ahead of price increases by the Congress and the various Administrations. The recent Quadrennial Advisory Council reports that from January 1940 to June 1974, social security benefits were increased 390.7% while prices were increasing 252.3%. From February 1963 to June 1974, benefits were increased 68.5% while prices rose 43.6%. From 1940 to 1975, the maximum tax paid by an employee rose from \$30 a year to \$824.85, and of course there are matching contributions from employers. This raises the question of whether future benefit costs will outstrip the ability or willingness of employers and employees to pay for them.

It is obvious that a complete reappraisal of the social security system is needed. All interested parties should participate in this evaluation of the present status and the proposed future growth of the system. Although financial soundness of the system is essential, the reappraisal should go beyond financing and any anticipated deficits. For example, there is a need to critically examine or re-examine the effects of social security on productivity, capital formation, and private savings; the relationship between private pensions and social security; the appropriate size of the trust funds; the question of indexing benefits in relation to inflation; the social adequacy and individual equity aspects of social security; the relationships among our tripartite income maintenance system, i.e., social insurance, private savings and employee benefits, and welfare or means-tested programs.

The National Chamber plans to participate in such an in-depth reappraisal. There must be a clear understanding by all citizens of how this social insurance system works if we are to expect continuing public support. This may require much more in the way of enlightenment as to costs and benefits, and such enlightenment about this large and complex system will take time. The anticipated deficits clearly show the dangers of overexpansion of the system in terms of both dollar costs and public confidence. Absolute candor is needed.

SHORT-TERM SOCIAL SECURITY PROBLEMS AND ISSUES

Background On Anticipated Deficits

On March 31, 1971, the 1971 Advisory Council on Social Security, appointed under Section 706 of the Social Security Act, reported its findings and recommendations to the Secretary of HEW. The Council reported in part on "Financing" or "Actuarial Soundness of the Program", as follows:

"1. Current Status—Adequate provision has been made in the law to meet all the costs of the cash benefits program both in the short run and over the long-range future; the cash benefit program is actuarially sound."

Then, during the 1972 election year, Congress voted a 20 percent general benefit increase and automatic cost-of-living escalators were built into the system. A general benefit increase of 11 percent became effective in two steps during 1974. Effective June 1975, the first automatic cost-of-living benefit of 8.0 percent was added to social security checks payable in July.

By March 7, 1975, HEW Secretary Weinberger was transmitting to Congress the findings and recommendations of the 1975 Advisory Council on Social Security. This Council reported on "Financing" and "Actuarial Status" as follows:

"The cash benefits program needs a comparatively small amount of additional financing immediately in order to maintain the trust funds levels. Beginning about 30 years from now, in 2005, the program faces serious deficits. Steps should be taken soon to assure the financial integrity and long-range financial soundness of the program."

Meanwhile, the 1974 Report of the Board of Trustees of OASDI had reported on the long-range deficit. More recently, two other reports, the Report of the Panel on Social Security Financing to the Senate Finance Committee and the 1975 Report of the Board of Trustees, confirm the current financial crisis and the serious long-range deficit.

In summary, since 1971 we have gone from a position of overall actuarial soundness in the social security cash benefits programs to a position where we face serious problems. The disparity between income and outgo began to develop with the enactment of the 1972 amendments, particularly the 20 percent general benefit increase and the cost-of-living escalators. Short-term, the OASDI program beginning this year and continuing indefinitely into the future will operate at a deficit with benefits paid exceeding income. The reserves in the cash-benefits trust funds will be depleted by the early 1980's. There are three major reasons for this shortfall: (1) higher levels of inflation than were assumed, resulting in higher benefits under the automatic cost-of-living escalators; (2) the large benefit increases voted by Congress in the last several years; (3) higher levels of unemployment which reduced expected payroll tax flows into the program.

Short-Term Financing Problem

The Chamber agrees that the short-term deficit is serious and requires early attention. There is no reason, however, for excessive concern or hasty action. There appears to be a need for up to a 1.0 percent payroll tax increase in the next few years, but other changes in the social security program also need to be considered. Meanwhile, we have equally serious problems to deal with.

Fortunately, we do have large social security trust funds. Congress exercised wisdom in creating these funds which are of a contingency nature and which are designed to meet crisis situations where payroll tax income is less than benefit payments.

The Board of Trustees has reported that the old-age and survivors trust fund had \$37.7 billion at the end of calendar year 1974. It estimated funds of \$35.6 billion by the end of 1975, \$31.3 billion by the end of 1976, and \$27.3 billion by the end of 1977.

If the old age and survivors insurance and disability insurance trust funds are combined, the figures for end of calendar year are: \$45.8 billion in 1974, \$42.9 billion in 1975, \$37.1 billion in 1976, and \$31.3 billion in 1977.

In addition, by the end of calendar year 1974, the medicare hospital insurance trust fund had assets of \$9.1 billion and the supplementary medical insurance trust fund had \$1.5 billion.

In summary, as we went into 1975, the OASDI trust funds totaled \$45.8 billion and the hospital and medical funds for Medicare totaled \$10.6 billion.

Furthermore, the OASDI trust funds earned \$2.5 billion in interest during fiscal '74, an effective annual rate of 6.0 percent on the total assets of the trust funds, according to the Board of Trustees. The hospital fund earned \$0.4 billion in interest, an annual rate of 6.7 percent.

Chamber Recommendations

The Chamber recommends that the trust funds be used for the purpose for which they were created and amassed—to tide us over this year and next until we can come out of the recession and increase employment. If there is a shortfall of \$3 billion this year as predicted, the 1974 interest earned on the trust funds should cover it or come close to covering it. The shortfall in 1976, depending on its size, should be financed by using the trust funds and can be done without lowering them to anywhere near a dangerous level, and this may be true in calendar 1977.

We realize that there are various arguments about the size at which the trust funds should be maintained. Experts argue that anywhere from a 3 month to a 1-year cushion should be maintained. Yet, all experts seem to agree that their estimates are subjective. There is no consensus. We should be able to arrive at one. Meanwhile, we see no danger in using the trust funds.

In the February White Paper issued by five former HEW Secretaries and three former Social Security Commissioners (Messrs. Richardson, Finch, Gardner, Cohen, Flemming and Messrs. Bell, Mitchell and Schottland), this statement was made:

"A government insurance system which has its future income assured by the taxing power has no need to build up the huge funds that a private insurer would require if it underwrote similar liabilities, and indeed, it would be unwise to the point of irresponsibility to accumulate such funds. The only need for a trust fund is as a contingency reserve large enough to tide the system over any temporary change in income and outgo; if an increase in revenues should be necessary, the trust fund would enable Congress to delay such action during a period of economic recession" (Italic added)

The Chamber is concerned that a payroll tax increase this year or next year would be counterproductive, would impede recovery and could hurt employment. The negative economic impact of an early payroll tax increase would be more severe than using the contingency reserves.

We do not know any compelling reason why the trust funds should not be temporarily used. There is no indication that employees, employers and the self-employed are prepared to accept a social security payroll tax increase while the economy is still sluggish and while inflation is still high. If Congress were to decide not to use the trust funds, then some explanation would have to be given to all social security taxpayers explaining why the over \$50 billion in additional taxes have been collected from them, why these contingency funds should not be used in the worst recession since the program was enacted, and why Congress would rather raise taxes than use the trust funds for their intended purpose.

The Chamber further recommends that the Committee on Ways and Means continue its study to determine if and when a payroll tax increase should be enacted to preserve the integrity of the social security funds in the next five to ten years. Any such tax should be supported equally by employers and employees. We oppose the use of general revenues because there are none available and because we cannot afford to turn the social security system into a welfare system. We also oppose raising the taxable wage base beyond that set by the automatic provisions because it would be unfair to middle income workers, would weaken confidence in the individual equity of the system, (We know the Committee understands that social security taxes will automatically increase in 1976 and thereafter as the contribution base is raised above \$14,100 to finance the automatic benefit escalators.)

We further recommend that, while the Committee is determining the amount and timing of any future social security payroll tax increase on employees and employers, it also addresses the following issues:

1. *Decoupling.*—Congress has rejected the Administration's proposal for a 5 percent cap on the 1975 cost-of-living increase. This cap would have avoided over two-thirds of the current deficit. Therefore, we recommend that the Committee move as expeditiously as possible to decouple. The Senate Panel, the Board of Trustees and the Advisory Council have all recommended such action. Decoupling would in effect cure the problem of double-indexing of benefits. The current provisions of law for automatically adjusting the benefit tables to reflect price changes and for computing average monthly earnings may result in unintended,

unpredictable and undesirable benefit levels. We have no specific recommendation for decoupling at this time. We understand both the Committee and the Administration have the matter under study. We plan to study the issue in depth and will welcome a future opportunity to comment on it. Decoupling needs priority attention.

2. *Universal Coverage.*—The Chamber recommends that the Committee move promptly to extend social security coverage to noncovered categories. The system does cover over 90 percent of workers, but virtually all gainful employment should be covered. Some 8½ million jobs are not covered. Over 2½ million of these jobs are in federal employment. Another 3½ million are in State and local employment. If there is some good reason why federal and other government employees should not have the privilege of contributing social security taxes and enjoying social security benefits, we do not know what it is. Such an extension of coverage would benefit initially the inflow of funds to the system.

3. *Inequities.*—The Chamber recommends that the Committee address the inequity issues that arise out of minimum benefits. The Advisory Council has documented how the minimum benefit frequently gives a windfall to federal retirees, who are already receiving a pension based on earnings not covered by social security. In addition, the system should not pay benefits over 100 percent of the indexed earnings on which it is based; and, in fact, a lesser percentage may be appropriate.

4. *Treatment of Men and Women.*—The Committee needs to study the problem of equal entitlement to dependent and survivors benefits. The Advisory Council has recommended that the law be changed to offset social security dependents' benefits for those who receive pensions from work not covered by social security.

5. *Private Pension Encouragement.*—The Chamber also recommends that the Committee on Ways and Means study additional ways to encourage private savings, especially for retirement. The Committee acted wisely in P.L. 93-406, the "Employee Retirement Income Security Act", to encourage the self-employed, their employees, and non-covered corporate employees to save for retirement. It is certainly more in the public interest to encourage individual and corporate saving for retirement during workers' earning years than to wait until they retire and then be faced with increasing taxes on the working population to pay higher social security benefits and welfare payments. Of equal importance is that encouragement of savings will assist in the capital formation needed for economic growth and job creation.

LONG-RANGE SOCIAL SECURITY PROBLEMS AND ISSUES

Long-range, the Board of Trustees of OASDI estimates a gap of 5.32 percent of taxable payroll over the 75 year period, 1975 to 2094. This translates into deficits exceeding a trillion dollars. Obviously, this is an extremely serious long-range problem.

In dealing with this problem, the Chamber recommends that Congress look at all of our economic security and income maintenance programs. The Nation's income maintenance system is complex. It involves private savings and property ownership, employee benefits, social insurance systems, and numerous means-tested welfare programs.

We simply cannot continue to expand existing or adopt new social insurance or welfare programs without considering their impact on national goals for growth. In this connection, it is worth reviewing the growth in the "welfare state and transfer economy", long range trends in corporate wages and supplements as related to after-tax profits, and the 10-year trend in employee benefits.

The "Welfare State and Transfer Economy"

We have, and are paying for, a welfare state. For those individuals and families unable to achieve economic security through employment, individual saving, social insurance and employee benefits, there is a fourth level of protection—the public welfare system.

The Subcommittee on Fiscal Policy of the Joint Economic Committee studied our nation's public welfare system over a period of three years. The Subcommittee concluded that some 35 million people are welfare recipients in the broadest sense. This number—more than 15 percent of the population—received some need-tested cash or non-cash benefit under one or more of the nation's public assistance programs. By the Subcommittee's count, there are today close to fifty separate need-tested public assistance programs. The largest of these include AFDC which provides cash benefits to about 11 million people, about three quarters of whom are in families headed by a woman; the Supplemental Security Income program (SSI), which pays cash benefits to approximately 6 million

low-income elderly, blind, and disabled persons; the food stamp program, which provides for the subsidized purchase of food by, now, over 15 million people; the Medicaid, program which provides free medical services to some 24 million people; and several housing programs, which provide low-rent housing, rent subsidies, and mortgage subsidies to nearly 2 million recipients.

The common feature of all such public assistance programs is that they are "need tested." In order to be eligible for benefits, one's income must be below some cut-off level and in some cases the value of his assets must also be below some specified level. It is the need testing or income testing of public assistance that distinguishes it primarily from social insurance. Under social insurance programs, such as Social Security, Medicare, and Unemployment Compensation, eligibility for benefits depends not on need but on one's past employment or contribution record. Total public assistance expenditures by all levels of government were \$37 billion in fiscal year 1973.

These public assistance programs are a part of our "transfer economy." Transfer payments have grown from about \$33 billion in 1962 to an estimated \$158.8 billion in 1975.

Traditionally in America, citizens have received income from the productivity of their labor or their property. This has been changing in the last forty years. In addition to our "market economy", we now have a growing "transfer economy".

The transfer economy has developed from the attempt to reconcile demands for equity and justice in the distribution of income and wealth with the requirement for efficiency in the marketplace. There is concern that the rapid growth of the "transfer economy" may be weakening the linkage among work, personal property and income that is necessary for the efficient operation of the market system.

The growth of this transfer economy and welfare state and their expected continued growth will have an impact on the growth of the private sector and the wages and employee benefits provided by corporations. Certain welfare states in Europe, such as Sweden, now clearly recognize the need to stimulate the growth of the private sector simply because a welfare state needs a vigorous business community to support it financially.

Trends in Corporate Wages and Salaries, Supplements and After Tax Profits

In trying to provide a basis for estimating where employee benefits are going in the future, it is helpful to briefly review what has happened since World War II to corporate wages and salaries, supplements, and after tax profits. Such a review raises valid concerns about the impact of the increasing costs of doing business and shrinking profits.

What people think about profits, to judge from surveys, is astonishingly far from the truth. Business after-tax profits are grossly overestimated. Opinion Research Corporation surveys show people think that the average manufacturer makes 28 percent after tax profits on sales. The actual average profit in 1973 was 4.7 percent, and about 5.8 percent in 1974. This gross over-estimate runs the gamut of society—professional and managerial people, blue collar workers, Democrats, Republicans, so-called thought leaders.

In any event, from 1946 to 1973, corporate wages and salaries increased from \$66.5 billion to \$416.6 billion, or 527%, as shown in Exhibit A.

Supplements to corporate wages and salaries increased during the same period from \$3.2 billion to \$65.9 billion, or 1,959%.

During this same period, after tax profits of corporations increased only 334%, from \$15.1 to \$65.6 billion.

(Using the third quarter of 1974 to estimate 1974 figures, corporate wages went to \$458 billion, a 590% increase since 1946; supplements went to \$74.3 billion, a 2,222% increase; and after tax profits jumped to \$87.2 billion, a 478% increase. The 1974 profits were exaggerated by inflation, specifically by under-depreciation and by over-valuation of inventories. Profits are expected to be down in 1975 from the 1974 high.)

In summary, the long term trend, over the last six business cycles, has been downward for after tax profits as a percent of corporate wages and salaries, and upward for supplements as a percent of such wages and salaries.

These statistics raise serious questions about the future rate of growth of employee benefits. Can employee wages and benefits increase if the long range trend of after tax profits as a percent of corporate wages and salaries continues downward?

Employee Benefits (1963 to 1973)

How employers' costs for employee benefits have increased over a recent ten year period is shown in Exhibit B. There has been a clear trend for the cost of employee benefits to rise almost twice as fast as the cost of increased wages and salaries. During the 10-year period from 1963 to 1973, average weekly earnings increased 77%, but the cost of employee benefits rose 126%.

Whether this trend will continue in the future is not clear. One could agree that in the face of continued inflation, employees will seek more take home pay. On the other hand, one could argue that in the face of increasing taxes on higher employee incomes, employees will seek their pay in more "tax free" benefits. But, these are only two conflicting arguments among the vast array of factors that determine the economic pay package, including wages and benefits.

It is worth noting also, as shown in Exhibit C, how the weekly costs of employee benefits varies among industries. Although the average cost per employee per week is \$62.12, the costs varied by industry from a high \$81.88 to a low of \$35.27. Beyond this, of course, there are company by company variances within industries.

Conclusion

The above facts and comments on the welfare state, transfer economy, corporate profits and employee benefits indicate the complexity of our income maintenance systems and our limitations in paying for them. Any comprehensive long-range study of social security needs to consider all the other relevant income maintenance programs and their costs.

EXHIBIT A

TABLE I.—TRENDS IN CORPORATE WAGES AND SALARIES, SUPPLEMENTS, AND AFTER TAX PROFITS, 1946-74

	Billions of dollars					
	Corporate wages and salaries	Supplements to corporate wages and salaries	Corporate after tax profits	Supplements as percent of wages and salaries	After tax profits as percent of wages and salaries	Supplements as percent of after tax profits
1946.....	66.5	3.2	15.1	4.8	22.7	21
1947.....	78.1	3.9	19.5	5.0	25.0	20
1948.....	86.9	4.2	21.8	4.8	25.1	19
1949.....	84.4	4.4	17.7	5.2	21.0	25
1950.....	92.9	5.7	23.9	6.1	25.7	24
1951.....	107.4	7.1	20.4	6.6	19.0	35
1952.....	115.4	7.6	18.5	6.6	16.0	41
1953.....	125.7	8.2	19.2	6.5	15.3	43
1954.....	123.4	8.7	19.1	7.1	15.5	46
1955.....	134.7	9.9	25.4	7.3	18.9	39
1956.....	145.8	11.3	25.3	7.7	17.2	45
1957.....	153.8	12.6	24.1	8.2	15.7	52
1958.....	151.1	12.8	20.6	8.5	13.6	62
1959.....	164.5	15.1	26.7	9.2	16.2	57
1960.....	172.1	16.7	24.8	9.7	14.4	67
1961.....	174.3	17.5	24.9	10.0	14.3	70
1962.....	186.1	19.8	28.7	10.6	15.4	69
1963.....	194.9	21.4	30.5	11.0	15.6	70
1964.....	208.7	22.9	35.3	11.0	16.9	65
1965.....	224.5	25.2	43.2	11.2	19.2	58
1966.....	246.1	29.5	46.7	12.0	19.0	63
1967.....	260.6	31.2	43.0	12.0	16.5	73
1968.....	284.3	35.2	43.8	12.4	15.4	80
1969.....	311.7	39.7	40.4	12.7	13.0	98
1970.....	325.8	43.2	34.6	13.2	10.6	125
1971.....	341.9	48.3	41.2	14.1	12.1	117
1972.....	374.7	56.0	52.4	14.9	14.0	107
1973.....	416.6	65.9	65.6	15.8	15.7	100
1974 IIIQ ¹	458.8	74.3	87.2	16.2	19.0	85

¹ Seasonally adjusted annual rate based on 3d quarter, 1974.

Note: Supplements to corporate wages and salaries include employer contributions to private pension and welfare funds and employer contributions for social insurance, such as old age, survivors and disability insurance, hospital insurance, State unemployment insurance, Federal unemployment tax, railroad retirement insurance, railroad unemployment insurance, and cash sickness compensation funds. It is estimated that these supplements include about 60 percent of the costs of what are commonly considered employee benefits. The remaining 40 percent include items like paid vacation, paid holidays, paid sick leave, and paid rest periods. The employer costs for these benefits paid for time not worked are included in corporate wages and salaries figures.

Source: "Survey of Current Business," U.S. Department of Commerce. Percentages computed by Chamber of Commerce of the United States.

EXHIBIT B

WEEKLY EXTRA BENEFIT COSTS, PER EMPLOYEE

	1973	1963	Percent change
Social security taxes.....	\$10.13	\$3.23	+214
Private pensions (nongovernment).....	9.67	4.19	+131
Paid vacations.....	8.96	4.62	+94
Insurance (life, sickness, accident, hospitalization, etc.).....	8.79	3.12	+182
Paid rest periods, lunch periods, wash-up time, etc.....	6.56	2.90	+126
Paid holidays.....	5.67	2.79	+103
Unemployment compensation taxes.....	2.25	1.83	+23
Profit-sharing payments.....	2.15	.96	+124
Paid sick leave.....	2.12	.75	+183
Workmen's compensation.....	1.77	.87	+103
Christmas or other special bonuses.....	.71	.54	+31
Contribution to employee thrift plans.....	.42	.10	+320
Employee meals furnished free.....	.42	.33	+27
Discounts on goods and services purchased from company by employees.....	.29	.21	+38
Other employee benefits.....	2.21	1.08	+105
Total employee benefits.....	92.12	27.52	+126
Average weekly earnings.....	189.96	107.52	+77

Source: "Employee Benefit 1973," Chamber of Commerce of the United States.

EXHIBIT C

WEEKLY EXTRA BENEFIT COSTS BY INDUSTRY—1973

	Per employee per week
All industries.....	\$62.12
Manufacturers:	
Petroleum.....	81.88
Chemicals and allied products.....	71.56
Transportation equipment.....	67.12
Primary metal.....	65.29
Machinery (excluding electrical).....	63.02
Fabricated metal products (excluding machinery and transportation equipment).....	62.33
Rubber, leather and plastic products.....	60.02
Stone, clay and glass products.....	58.83
Food, beverages and tobacco.....	58.15
Instruments and miscellaneous products.....	57.98
Electrical machinery, equipment and supplies.....	55.38
Printing and publishing.....	54.87
Pulp, paper, lumber and furniture.....	53.73
Textile products and apparel.....	35.27
Nonmanufacturing:	
Public utilities.....	75.33
Banks, finance and trust companies.....	64.31
Miscellaneous industries (mining, transportation, research, warehousing, etc.).....	61.38
Insurance companies.....	61.33
Wholesale and retail trade (excluding department stores).....	45.10
Department stores.....	37.79

Source: "Employee Benefits 1973," Chamber of Commerce of the United States.

STATEMENT OF THE COMMITTEE ON AGING, COMMUNITY SERVICE SOCIETY,
NEW YORK, N.Y.

We have carefully studied the 1973, 1974 and 1975 Reports of the Board of Trustees of the OASDI Funds, the recent Report of the Federal Advisory Council and the report on the Senate Finance Committee Panel on Social Security Financing. We applaud the decision of your Committee to concentrate at the present time on the short run financing problem, both because these are immediately facing us and because the longer run picture is heavily influenced by what we regard as the highly unreliable projections of demographic and economic trends running over a period of 75 years. It is noteworthy that the Trustees in the 1975 Report warned of the difficulty of making long run projections and their own Actuary showed how greatly the financial picture would be changed by relatively small changes in the assumptions regarding trends in cost of living and in wages.

We would however urge you at the present time to concentrate on the financial problems of the next 5 rather than 25 years. Even over the shorter run we have been impressed by the unreliability of estimates. It is significant that there have been large differences in the size of the deficit as estimated by the three most recent Trustees Reports, differences that are attributable to changes in the demographic and economic assumptions of the respective reports. Even in the very short run it is disturbing to find that different economic assumptions were adopted by the 1975 Trustees, reporting in May 1975 from those adopted in the President's 1976 Budget which appeared only a few months earlier.

We have also been unable to determine how much of the annual deficit projected for the next five years is attributable to a decline in previously estimated tax yields and how much to higher expenditures (due to the automatic cost of living increases, to growth in disability claims and the trend to earlier retirement). To the extent that the deficit stems from falling tax receipts (or a slower rate of growth than previous official estimates has predicted) drawing on the reserve fund should occasion no alarm, provided the recession does not last for more than two or three years, for this is precisely the contingency the reserve was created to deal with.

To the extent that the deficiency stems from projected expenditures that are higher than previously assumed, there may indeed be a need for additional revenues even in the short run. Some reduction of anticipated expenditures can be expected if the Congress amends the cost of living provisions so as to eliminate the double cost of living gain reaped by future retirees (the so-called "decoupling" proposals). But the savings from this action will be mainly felt in the more distant future. For the years immediately ahead it seems possible that even if the employment levels return to pre-recession levels within the next year or two, there may well be a need for additional revenues.

We believe that it would be highly undesirable to seek to secure these needed funds from further increases in the wage and payroll taxes.

The burden of the wage and payroll tax is already very heavy not merely on low, but also on middle income receivers and this is true even if one considers only the tax levy on the worker, let alone if, as most economists would argue, the employer's tax is also ultimately borne by the worker. It falls especially heavily on the poor because of the regressive character of these taxes (the absence of deductions and exemptions, the uniform tax rate at all earnings levels and the non-payment of taxes on earnings in excess of \$14,100).

We take a dim view of proposals to lessen the burden on low earners by providing the kinds of exemptions and deductions now characteristic of the federal income tax, and also of the more radical proposal to exempt from taxation those with earnings below some specified income level. Such adjustments in the wage tax will be administratively complicated. Removal of tax liability from workers earnings below a specified level will raise difficult policy decisions regarding the selection of the precise level at which tax liability will be removed.

So long as the policy of sole reliance on wage and payroll taxes for financing OASDI remains, both proposals, and especially the second, will involve sharp increases in the social security taxes paid by higher paid workers. While this might result in a less regressive financing system than we now have, there may well be strong resistance on the part of these higher paid workers in view of the heaviness of the present tax and the belief of these groups that they are already getting out of the OASDI system benefits that are disproportionately small as compared to those received by low earners.

Both proposals too raise problems for a wage-related contributory system. Both will mean that many millions of covered workers will pay no taxes at all. Are they to receive a uniform benefit? If not, how are their differential benefits to be determined in the absence of wage records? What will be the reaction of the tax-paying workers, especially those just above the exempt level, to the receipt of benefits only slightly higher than those received by workers who have not contributed?

An alternative proposal to retain sole reliance on wage and payroll taxes, without increasing the *tax rate*, namely to raise the taxable earnings limit, while at first sight more appealing, and certainly preferably to remitting, or reducing, Social Security taxes on low earners, has also disadvantages. Since OASDI is an earnings-related benefit system, raising the taxable limit will also raise (although not proportionately) the benefits received by higher earners. This will cut into the net gains from raising the taxable limit. More importantly, the proposal raises a question about the social desirability of compelling earners at income levels as high as \$24,000 to provide for their old age security through the OASDI system. At some income level it would seem desirable to leave them free, if they desire a

retirement income higher than some modest OASDI benefit, to do so through the private sector. We would like further exploration of the potential contribution of an increased wage base in the light of these problems.

We are strongly opposed to the proposal of the Federal Advisory Council that the wage and payroll taxes now collected for Medicare should be utilized for financing OASDI and that Medicare should be wholly financed from the general revenues. We firmly believe in the principle of contributory social insurance. Although, as we shall later argue, this does not rule out some contribution from the general revenues, we are opposed to *exclusive* reliance on general revenue financing. As has frequently been argued, the contributory element serves to underpin the right to a payment or benefit and to insulate the program to some degree from a lowering of benefit levels or imposition of income or means tests as a condition of eligibility in temporary periods of federal budgetary stringency. The very arguments used by the Advisory Council in rejecting even a limited contribution from general revenues to the OASDI system apply with even greater force to their proposal that Medicare should be wholly financed from general revenues.

We believe rather that such short run deficit as a careful examination of economic trends may reveal should be met by the infusion of funds from the general revenues, which are less regressive in their impact than wage and payroll taxes. Indeed, we would go further and recommend that general tax revenues should not be limited to merely the short run deficit but should be sufficient to permit a lowering of the present level of the social security taxes. It is relevant in this connection to recognize that any health insurance program that is likely to be enacted will assuredly rely at least in part on wage and payroll taxes for its financing. On top of the social security taxes at their present level, this would mean an intolerably heavy burden, especially on low earners.

The proposal for some "government contribution" is neither revolutionary nor novel. It is common in most well-established foreign social insurance systems. It was envisaged legislatively in this country during the late 1940's when Congress continually postponed the then scheduled increases in the social security taxes. It is already adopted in the financing of the special "age-72" benefits and in the financing of Part B of Medicare.

THE FINANCING OF SOCIAL SECURITY

(By Edward F. Renshaw, Department of Economics, State University of New York at Albany)

The present system of financing social security is biased against work sharing in periods of widespread unemployment. It also discourages employers from hiring disadvantaged workers, students, part-time, and other low income wage earners. These biases are related to the fact that wage and salary payments above a threshold amount are exempt from social security taxes. Profits will be maximized, other things equal, if employers retain workers who have already earned the threshold amount rather than new employees and less skilled workers that have not yet made a maximum contribution to social security.

One way to encourage employers to both hire and retain more disadvantaged workers would be to simply exempt the first three or four thousand dollars of a worker's income from all social security taxes and make up the loss in tax revenue by requiring workers and employers to contribute a fixed proportion of all additional wage and salary payments to the Social Security Fund. These reforms would also have the advantage of making our social security system less regressive.

If they were enacted and if minimum social security benefits were raised by a comparable amount, Congress—in good conscience—could then help to solve the current energy problem by channeling the proceeds from higher gasoline taxes into the Social Security Fund.

The United States is about the only "oil poor" industrialized nation that does not levy a large tax on gasoline of 50 cents or more per gallon to limit the demand for imported oil. Drivers in other countries, as a consequence, have a greater incentive to buy smaller cars, organize car pools, drive at lower operating speeds, utilize mass transit, and in other ways help to conserve energy.

If the United States were to emulate the tax structure of other importing nations and use gasoline taxes to improve our social security system, that would probably be sufficient to seriously weaken the international oil cartel, keep the

price of imported oil from rising further, and enable the U.S. to play a more effective role in bringing about a peaceful settlement of the Arab-Israeli dispute. It is not unreasonable to suppose that there might be other advantages.

If American motorists could be confident that higher gasoline taxes will be enacted in the near future and used to fund social security that would provide them with a stronger incentive to quickly switch to smaller automobiles. This in turn could lead to a revival of economic activity in other industries, a more rapid growth of the employed labor force, an automatic increase in the amount of funds flowing into the Social Security Trust Fund and a reduced need for tax rate increases to keep our social security system financially healthy in the remainder of this decade.

STATEMENT OF DANIEL M. ROHRER,¹ BOSTON COLLEGE, CHESTNUT HILL, MASS.

The present problems in financing the Social Security program arise from the current economic situation. Such recessions should serve as the only threat to the short-range financing of the program during the next 25 years. In the following century there is a possibility of a problem in Social Security financing which derives from an expected change in the age composition of the population. If the commitments of Social Security are met by the U.S. Government, additional financing will be needed.

It would be unwise economics to raise Social Security contributions, taxes or premiums at this time but the deficits cannot continue either. Yet it is essential that the income to the program be raised to an excess of the benefit payments that must be made when the economy recovers. For there are positive effects when income transfers are soundly financed. Although the income tax does not fund an individual insurance retirement benefit, there is a general belief that it does. This also makes any fundamental change in the tax system unrealistic at the moment. However, certain reforms in the structure of these taxes may be feasible to distribute the burden of Social Security taxes more generally among the whole population of income receivers. Finally, those who oppose drawing from the general revenues usually do so for the reason that Social Security was established to pay for itself, and that drawing from general funds tends to turn it into a type of welfare rather than insurance. The experience of public assistance augments unwillingness of taxpayers to help their fellow citizens who are believed to be somehow able to support themselves. It is unlikely that taxpayers would be willing to provide noncontributory benefits without a means test and at a comparable level of adequacy to the 30 million people who now receive Social Security benefits. This would include the elderly, the disabled and their dependents, the widows and the widowers, and the motherless or fatherless children. Nevertheless, the American public must be convinced that social and economic benefits grow out of cushions against unemployment and old age, and that it is not unreasonable to expect the government to organize this kind of protection.

The system functions by withdrawing purchasing power from the present generation of workers and transferring it to the present generation of retired persons at the benefit rates the Congress has decided is appropriate. The only need for a trust fund is as a contingency reserve large enough to tide the system over any temporary change in income and outflow. If an increase in revenues should be necessary, the trust fund would enable Congress to delay such action during a period of economic recession. Therefore, until a decade or so after the turn of the century, when the active labor force in the U.S. may be required to support relatively more retired people than was thought to be the case until recently, a shift to financing the Social Security program through general revenue should be painless and devoid of harmful consequences if done so during a time of economic prosperity. Within the next two years such conditions are likely to prevail, and this period of economic recovery would be the most expedient time to make such a basic change. At this time premiums should be substantially increased as well for other means of assistance are limited in their scope and coverage. In the meantime, if it is necessary to meet needs and commitments through deficit financing, this should be done until the economy improves sufficiently to allow for increased taxes without harmful results.

¹ Professor Rohrer is Director of Forensics at Boston College.

STATEMENT OF J. A. SCHNEPPER, RUTGERS COLLEGE, NEW BRUNSWICK, N.J.

SOCIAL SECURITY—FINANCING THE QUAGMIRE

The Social Security Board of Trustees has released its 1975 report detailing the financial cancer eating away at its fund of potential benefits for the American worker. On this year alone, outlays in our retirement system will exceed receipts by \$2.5 billion and, with reserves falling to \$43.4 billion, by 1980 our fund will have dried up to less than \$800 million, not enough to cover a week's benefits!

The situation is deteriorating at an increasing rate. This year's \$2.5 billion deficit will be followed by a shortage of \$6.8 billion next year and \$8.3 billion in the year after that. Clearly to honor commitments to the system's 30 million beneficiaries, sizable infusions of revenue will soon be required. In the short run, the fund needs at least \$7 billion a year. With increasing dollar deflation, some actuaries contend the sum should be \$10 billion. The key question, though, is how this revenue should be financed.

In order to better understand the parameter of solutions, we must begin by first detailing the causes of the problem, and how these causes fit into the structure of our Social Security System.

Our problem is one of basic economic disequilibrium—outflows exceeding inflows. Our projected revenue decline is the product of several interrelated factors. The first of which is a deeper decline in future birth rates. The experts foresee a dip in the next few years to an average of 1.2 children for each woman of childbearing age from the current level of 1.9, and then a gradual climb to a rate of 2.1 children. The impact of this will be to further increase the ratio of retirees to workers in future years from 30 for every 100 workers today, to about 50 for each 100 workers by the year 2030. The 21st Century, therefore, will have fewer workers contributing the funds necessary to support a large pool of aged retirees.

A second threat to our Social Security System is inflation. Higher prices force payment of bigger benefits but don't adequately increase revenues to the trust funds. Escalating automatic cost of living adjustments present the situation where some workers will actually receive more in retirement than they earned on the job. The Ford administration already has announced an 8% benefit increase, effective in July, and the trustee report projects future automatic increases of 6.6% next year, 6.4% in 1977 and 6.3% in 1978 before there is any significant decrease in the automatic escalator. But with one-half of the people on Social Security receiving no other benefits, without any private pensions to feed and clothe them, a cut back in inflationary-based catch-up increases would be both politically and morally impossible.

With inflation increasing the cash outflow, and the combination of declining birth rates with increased old aged population reducing the inflow, the potential cash balances of our Social Security System are in serious trouble. The most immediate danger though, and the one with the greatest short term impact, is unemployment. Social Security revenue is payroll tax revenue. The unemployed do not pay Social Security taxes on their unearned wages; neither do their "employers." Clearly our record 9.2% and almost 9,000,000 unemployed do not add hope to balancing our Social Security trust budgets.

The problem, therefore, is one of financing additional revenue from a decreasing growth population to support increasing program benefits. Our present Social Security system actually consists of three separate programs providing retirement and survivor benefits, payments to disabled workers, and health insurance for the aged—best known as Medicare. These programs are financed by separate trust funds, fed mainly by the 11.7% payroll tax which includes a special Medicaid levy.

Each employee is taxed on his first \$14,000 annual earnings at a rate of 5.85%. His maximum contribution, therefore, is \$824.85. This is matched by an equal 5.85% tax on his employer. Under the current law, the wage base automatically will increase to about \$15,300 in 1976, to \$16,800 in 1977, and an expected \$19,800 by 1979. The 5.85% tax rate will also increase in 1977 to 6.05% because of a boost scheduled for the Medicare program. In total, by 1979, the maximum Social Security contribution would be up to \$1,197.90, an increase of 45%.

Here lies the primary focus of most analysts. Do we finance our increased benefit payout with a further increase in the tax rate, which affects all workers, or with a further raising of the wage base, affecting only the marginal 15% of the workers making the present maximum?

Proponents of a tax rate increase fear a jump in the wage base would disproportionately hit middle and upper middle income workers and expand the coverage of the Social Security program by providing bigger pensions keyed to higher

wages. Businessmen, led by the insurance industry, fear the potential expansion of retirement benefits would encroach on private pension plans. J. Henry Smith, Chairman of the Equitable Life Assurance Society of New York City has said, "Our industry thinks the wage base is already too high." Advocates of expanding the *wage base* argue against the regressivity of increasing the tax rate. Eighty-five percent of the American working population has presently 5.85% of each dollar of *all* of his wages taxed. Worse still, he is doubly taxed by having each of those Social Security tax dollars that he never sees retaxed as income. A family of four earning \$4300 a year is too poor to pay federal income taxes. Yet they must presently put out \$251.55 in Social Security contributions. Surely increasing their tax rate and payout can not be an optimal objective solution.

A third proposal has been put forth—that of an infusion of general tax revenues. The Ford Administration has resisted this idea fearing that it would weaken workers' willingness to contribute to their own retirement. They demand that the "earned right" principle be preserved. Conservatives contend that general revenue financing is a step toward converting Social Security from an insurance plan into a welfare program.

I can not agree with the anti general revenue forces. When one has absolutely no choice as to the insurance he is buying, not the amount, the carrier, the cost, nor the benefits, he is not buying insurance. He is being *taxed*! The political considerations of the 1930's which demanded the word "welfare" be hidden under the guise of "insurance" no longer apply to the 1970's.

As a short term remedial step therefore, I would accept the recommendation made by the Social Security Advisory Council. They would finance the Medicare payments out of general revenues instead of from the 1.8% health insurance tax that is part of the 11.7% Social Security payroll tax. The 1.8% would be used to meet the deficit in the retirement and disability funds.

While the above would be the first aboveboard step in the recognition of general revenue subsidies for Social Security it would be nothing new. Precedents currently exist. Payments from general revenues are now being made with respect to the cost of (1) gratuitous wage credits for certain military service, (2) hospital insurance benefits for certain uninsured aged persons initially blanketed-in at the start of the Medicare program, (3) uniform cash benefits for certain persons aged 72 and over who attained such age before 1972, and (4) the matching amounts with respect to the premiums paid for persons covered by Supplemental Medical Insurance.

But let me reemphasize though, in conclusion, that general revenue infusions must be viewed as a short stop gap solution. We must cure the disease rather than just cover up its symptoms. There is a limit to the extent that even the American public will pay increased taxes.

The crisis of our Social Security system is the crisis of our current economic situation. It is caused by the twin terrors of inflation and unemployment. As we apply a general revenue bandage to Social Security, we must press forward in our attack against the dual diseases which produced the wound.

[Whereupon, at 4 p.m., the hearing was adjourned.]



DATE DUE

[illegible]

KF 27 .W347 1975

United States. Congress.
House. Committee on Ways

Financing the social
security system

5763YF PR 491 Group
03-21-12 16207 XL THE

CMS LIBRARY



3 8095 00009605 3